GOLDMAN SACHS GROUP INC
Form 10-Q
May 10, 2012
Table of Contents

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 March 31, 2012

or

¨ **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.)**
200 West Street, New York, N.Y. **(Address of principal executive offices)**	10282 **(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 ¨ No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

x Yes ¨ 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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer x Accelerated filer ¨

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

¨ Yes x No

APPLICABLE ONLY TO CORPORATE ISSUERS

As of April 27, 2012, there were 491,877,148 shares of the registrant s common stock outstanding.

Table of Contents

THE GOLDMAN SACHS GROUP, INC.

QUARTERLY REPORT ON FORM 10-Q FOR THE QUARTER ENDED MARCH 31, 2012

INDEX

Form 10-Q Item Number		Page No.
PART I	**FINANCIAL INFORMATION**	**2**
Item 1	**Financial Statements (Unaudited)**	**2**
	Condensed Consolidated Statements of Earnings for the three months ended March 31, 2012 and March 31, 2011	2
	Condensed Consolidated Statements of Comprehensive Income for the three months ended March 31, 2012 and March 31, 2011	3
	Condensed Consolidated Statements of Financial Condition as of March 31, 2012 and December 31, 2011	4
	Condensed Consolidated Statements of Changes in Shareholders Equity for the three months ended March 31, 2012 and year ended December 31, 2011	5
	Condensed Consolidated Statements of Cash Flows for the three months ended March 31, 2012 and March 31, 2011	6
	Notes to Condensed Consolidated Financial Statements	**7**
	Note 1. Description of Business	7
	Note 2. Basis of Presentation	7
	Note 3. Significant Accounting Policies	8
	Note 4. Financial Instruments Owned, at Fair Value and Financial Instruments Sold, But Not Yet Purchased, at Fair Value	12
	Note 5. Fair Value Measurements	13
	Note 6. Cash Instruments	15
	Note 7. Derivatives and Hedging Activities	23
	Note 8. Fair Value Option	37
	Note 9. Collateralized Agreements and Financings	45
	Note 10. Securitization Activities	48
	Note 11. Variable Interest Entities	51
	Note 12. Other Assets	56
	Note 13. Goodwill and Identifiable Intangible Assets	57
	Note 14. Deposits	59
	Note 15. Short-Term Borrowings	60
	Note 16. Long-Term Borrowings	61
	Note 17. Other Liabilities and Accrued Expenses	65
	Note 18. Commitments, Contingencies and Guarantees	66
	Note 19. Shareholders Equity	72
	Note 20. Regulation and Capital Adequacy	75
	Note 21. Earnings Per Common Share	79
	Note 22. Transactions with Affiliated Funds	80
	Note 23. Interest Income and Interest Expense	81
	Note 24. Income Taxes	81
	Note 25. Business Segments	82
	Note 26. Credit Concentrations	86
	Note 27. Legal Proceedings	87
	Report of Independent Registered Public Accounting Firm	**101**
	Statistical Disclosures	**102**
Item 2	**Management's Discussion and Analysis of Financial Condition and Results of Operations**	**105**
Item 3	**Quantitative and Qualitative Disclosures About Market Risk**	**169**
Item 4	**Controls and Procedures**	**169**
PART II	**OTHER INFORMATION**	**169**
Item 1	**Legal Proceedings**	**169**
Item 2	**Unregistered Sales of Equity Securities and Use of Proceeds**	**170**
Item 6	**Exhibits**	**171**
SIGNATURES		**172**

Table of Contents

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 March	
in millions, except per share amounts	**2012**	2011
Revenues		
Investment banking	**$1,160**	$ 1,269
Investment management	**1,105**	1,174
Commissions and fees	**860**	1,019
Market making	**3,905**	4,462
Other principal transactions	**1,938**	2,612
Total non-interest revenues	**8,968**	10,536
Interest income	**2,833**	3,107
Interest expense	**1,852**	1,749
Net interest income	**981**	1,358
Net revenues, including net interest income	**9,949**	11,894
Operating expenses		
Compensation and benefits	**4,378**	5,233
Brokerage, clearing, exchange and distribution fees	**567**	620
Market development	**117**	179
Communications and technology	**196**	198
Depreciation and amortization	**433**	590
Occupancy	**212**	267
Professional fees	**234**	233
Insurance reserves	**157**	88
Other expenses	**474**	446
Total non-compensation expenses	**2,390**	2,621
Total operating expenses	**6,768**	7,854
Pre-tax earnings	**3,181**	4,040
Provision for taxes	**1,072**	1,305
Net earnings	**2,109**	2,735
Preferred stock dividends	**35**	1,827
Net earnings applicable to common shareholders	**$2,074**	$ 908
Earnings per common share		
Basic	**$ 4.05**	$ 1.66
Diluted	**3.92**	1.56
Dividends declared per common share	**$ 0.35**	$ 0.35
Average common shares outstanding		
Basic	**510.8**	540.6
Diluted	**529.2**	583.0

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

Table of Contents

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Comprehensive Income

(Unaudited)

	Three Months Ended March	
in millions	**2012**	2011
Net earnings	**$2,109**	$2,735
Other comprehensive income/(loss), net of tax:		
Currency translation adjustment, net of tax	**(28)**	(22)
Pension and postretirement liability adjustments, net of tax	**7**	1
Net unrealized gains/(losses) on available-for-sale securities, net of tax	**30**	(23)
Other comprehensive income/(loss)	**9**	(44)
Comprehensive income	**$2,118**	$2,691

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

Table of Contents

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Financial Condition

(Unaudited)

	As of	
in millions, except share and per share amounts	**March 2012**	December 2011
Assets		
Cash and cash equivalents	**$ 57,138**	$ 56,008
Cash and securities segregated for regulatory and other purposes (includes $33,679 and $42,014 at fair value as of March 2012 and December 2011, respectively)	**53,099**	64,264
Collateralized agreements:		
Securities purchased under agreements to resell and federal funds sold (includes $181,050 and $187,789 at fair value as of March 2012 and December 2011, respectively)	**181,050**	187,789
Securities borrowed (includes $57,062 and $47,621 at fair value as of March 2012 and December 2011, respectively)	**169,092**	153,341
Receivables from brokers, dealers and clearing organizations	**16,886**	14,204
Receivables from customers and counterparties (includes $8,328 and $9,682 at fair value as of March 2012 and December 2011, respectively)	**65,211**	60,261
Financial instruments owned, at fair value (includes $67,404 and $53,989 pledged as collateral as of March 2012 and December 2011, respectively)	**385,506**	364,206
Other assets	**22,950**	23,152
Total assets	**$ 950,932**	$923,225
Liabilities and shareholders equity		
Deposits (includes $5,524 and $4,526 at fair value as of March 2012 and December 2011, respectively)	**$ 50,874**	$ 46,109
Collateralized financings:		
Securities sold under agreements to repurchase, at fair value	**173,092**	164,502
Securities loaned (includes $550 and $107 at fair value as of March 2012 and December 2011, respectively)	**8,121**	7,182
Other secured financings (includes $28,367 and $30,019 at fair value as of March 2012 and December 2011, respectively)	**33,139**	37,364
Payables to brokers, dealers and clearing organizations	**3,678**	3,667
Payables to customers and counterparties	**206,627**	194,625
Financial instruments sold, but not yet purchased, at fair value	**151,251**	145,013
Unsecured short-term borrowings, including the current portion of unsecured long-term borrowings (includes $17,772 and $17,854 at fair value as of March 2012 and December 2011, respectively)	**48,721**	49,038
Unsecured long-term borrowings (includes $17,509 and $17,162 at fair value as of March 2012 and December 2011, respectively)	**171,592**	173,545
Other liabilities and accrued expenses (includes $9,451 and $9,486 at fair value as of March 2012 and December 2011, respectively)	**32,181**	31,801
Total liabilities	**879,276**	852,846
Commitments, contingencies and guarantees		
Shareholders equity		
Preferred stock, par value $0.01 per share; aggregate liquidation preference of $3,100 as of both March 2012 and December 2011	**3,100**	3,100
Common stock, par value $0.01 per share; 4,000,000,000 shares authorized, 808,213,029 and 795,555,310 shares issued as of March 2012 and December 2011, respectively, and 495,210,854 and 485,467,565 shares outstanding as of March 2012 and December 2011, respectively	**8**	8
Restricted stock units and employee stock options	**3,889**	5,681
Nonvoting common stock, par value $0.01 per share; 200,000,000 shares authorized, no shares issued and outstanding		
Additional paid-in capital	**47,035**	45,553
Retained earnings	**60,723**	58,834
Accumulated other comprehensive loss	**(507)**	(516)
Stock held in treasury, at cost, par value $0.01 per share; 313,002,177 and 310,087,747 shares as of March 2012 and December 2011, respectively	**(42,592)**	(42,281)
Total shareholders equity	**71,656**	70,379
Total liabilities and shareholders equity	**$ 950,932**	$923,225

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

Table of Contents

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Changes in Shareholders Equity

(Unaudited)

	Three Months Ended March	Year Ended December
in millions	**2012**	2011
Preferred stock		
Balance, beginning of year	**$ 3,100**	$ 6,957
Repurchased		(3,857)
Balance, end of period	**3,100**	3,100
Common stock		
Balance, beginning of year	**8**	8
Issued		
Balance, end of period	**8**	8
Restricted stock units and employee stock options		
Balance, beginning of year	**5,681**	7,706
Issuance and amortization of restricted stock units and employee stock options	**640**	2,863
Delivery of common stock underlying restricted stock units	**(2,415)**	(4,791)
Forfeiture of restricted stock units and employee stock options	**(16)**	(93)
Exercise of employee stock options	**(1)**	(4)
Balance, end of period	**3,889**	5,681
Additional paid-in capital		
Balance, beginning of year	**45,553**	42,103
Issuance of common stock		103
Delivery of common stock underlying share-based awards	**2,419**	5,160
Cancellation of restricted stock units in satisfaction of withholding tax requirements	**(872)**	(1,911)
Excess net tax benefit/(provision) related to share-based awards	**(64)**	138
Cash settlement of share-based compensation	**(1)**	(40)
Balance, end of period	**47,035**	45,553
Retained earnings		
Balance, beginning of year	**58,834**	57,163
Net earnings	**2,109**	4,442
Dividends and dividend equivalents declared on common stock and restricted stock units	**(185)**	(769)
Dividends on preferred stock	**(35)**	(2,002)
Balance, end of period	**60,723**	58,834
Accumulated other comprehensive income/(loss)		
Balance, beginning of year	**(516)**	(286)
Other comprehensive income/(loss)	**9**	(230)
Balance, end of period	**(507)**	(516)
Stock held in treasury, at cost		
Balance, beginning of year	**(42,281)**	(36,295)
Repurchased	**(368)**	(6,051)
Reissued	**57**	65
Balance, end of period	**(42,592)**	(42,281)
Total shareholders equity	**$ 71,656**	$ 70,379

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

Table of Contents

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows

(Unaudited)

	Three Months Ended March	
in millions	**2012**	2011
Cash flows from operating activities		
Net earnings	**$ 2,109**	$ 2,735
Non-cash items included in net earnings		
Depreciation and amortization	**433**	594
Share-based compensation	**643**	1,512
Changes in operating assets and liabilities		
Cash and securities segregated for regulatory and other purposes	**11,165**	219
Net receivables from brokers, dealers and clearing organizations	**(2,671)**	568
Net payables to customers and counterparties	**7,052**	(9,671)
Securities borrowed, net of securities loaned	**(14,813)**	(16,901)
Securities sold under agreements to repurchase, net of securities purchased under agreements to resell and federal funds sold	**15,328**	29,391
Financial instruments owned, at fair value	**(22,023)**	(14,701)
Financial instruments sold, but not yet purchased, at fair value	**6,304**	10,278
Other, net	**11**	(2,124)
Net cash provided by operating activities	**3,538**	1,900
Cash flows from investing activities		
Purchase of property, leasehold improvements and equipment	**(390)**	(277)
Proceeds from sales of property, leasehold improvements and equipment	**13**	9
Business acquisitions, net of cash acquired	**(39)**	(5)
Proceeds from sales of investments	**130**	216
Purchase of available-for-sale securities	**(653)**	(761)
Proceeds from sales of available-for-sale securities	**699**	930
Net cash provided by/(used for) investing activities	**(240)**	112
Cash flows from financing activities		
Unsecured short-term borrowings, net	**(869)**	1,501
Other secured financings (short-term), net	**(483)**	1,340
Proceeds from issuance of other secured financings (long-term)	**798**	1,291
Repayment of other secured financings (long-term), including the current portion	**(4,334)**	(3,580)
Proceeds from issuance of unsecured long-term borrowings	**9,358**	8,805
Repayment of unsecured long-term borrowings, including the current portion	**(11,134)**	(7,364)
Derivative contracts with a financing element, net	**208**	210
Deposits, net	**4,765**	158
Common stock repurchased	**(365)**	(1,481)
Dividends and dividend equivalents paid on common stock, preferred stock and restricted stock units	**(220)**	(358)
Proceeds from issuance of common stock, including stock option exercises	**39**	63
Excess tax benefit related to share-based compensation	**70**	333
Cash settlement of share-based compensation	**(1)**	(35)
Net cash provided by/(used for) financing activities	**(2,168)**	883
Net increase in cash and cash equivalents	**1,130**	2,895
Cash and cash equivalents, beginning of year	**56,008**	39,788
Cash and cash equivalents, end of period	**$ 57,138**	$ 42,683

SUPPLEMENTAL DISCLOSURES:

Cash payments for interest, net of capitalized interest, were $4.04 billion and $2.71 billion during the three months ended March 2012 and March 2011, respectively.

Income tax refunds, net of cash payments, were $29 million during the three months ended March 2012. Cash payments for income taxes, net of refunds, were $296 million during the three months ended March 2011.

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

Table of Contents

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Note 1. Description of Business

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 financial services to a substantial and diversified client base that includes corporations, financial institutions, governments and high-net-worth individuals. Founded in 1869, the firm is headquartered in New York and maintains offices in all major financial centers around the world.

The firm reports its activities in the following four business segments:

Investment Banking

The firm provides a broad range of investment banking services to a diverse group of corporations, financial institutions, investment funds and governments. Services include advisory assignments with respect to mergers and acquisitions, divestitures, corporate defense activities, risk management, restructurings and spin-offs, and debt and equity underwriting of public offerings and private placements, as well as derivative transactions directly related to these activities.

Institutional Client Services

The firm facilitates client transactions and makes markets in fixed income, equity, currency and commodity products, primarily with institutional clients such as corporations, financial institutions, investment funds and governments. The firm also makes markets and clears client transactions on major stock, options and futures exchanges worldwide and provides financing, securities lending and prime brokerage services to institutional clients.

Investing & Lending

The firm invests in and originates loans to provide financing to clients. These investments and loans are typically longer-term in nature. The firm makes investments, directly and indirectly through funds that the firm manages, in debt securities, loans, public and private equity securities, real estate, consolidated investment entities and power generation facilities.

Investment Management

The firm provides investment management 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 set of institutional and individual clients. The firm also offers wealth advisory services, including portfolio management and financial counseling, and brokerage and other transaction services to high-net-worth individuals and families.

Note 2. Basis of Presentation

Note 2.

Basis of Presentation

These condensed consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP) and include the accounts of Group Inc. and all other entities in which the firm has a controlling financial interest. Intercompany transactions and balances have been eliminated.

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 year ended December 31, 2011. References to the firm s Annual Report on Form 10-K are to the firm s Annual Report on Form 10-K for the year ended December 31, 2011. The condensed consolidated financial information as of December 31, 2011 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.

All references to March 2012 and March 2011 refer to the firm s periods ended, or the dates, as the context requires, March 31, 2012 and March 31, 2011, respectively. All references to December 2011 refer to the date December 31, 2011. Any reference to a future year refers to a year ending on December 31 of that year. Certain reclassifications have been made to previously reported amounts to conform to the current presentation.

Table of Contents

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Note 3. Significant Accounting Policies

Note 3.

Significant Accounting Policies

The firm s significant accounting policies include when and how to measure the fair value of assets and liabilities, accounting for goodwill and identifiable intangible assets, and when to consolidate an entity. See Notes 5 through 8 for policies on fair value measurements, Note 13 for policies on goodwill and identifiable intangible assets, and below and Note 11 for policies on consolidation accounting. All other significant accounting policies are either discussed below or included in the following footnotes:

Financial Instruments Owned, at Fair Value and Financial Instruments Sold, But Not Yet Purchased, at Fair Value	Note 4
Fair Value Measurements	Note 5
Cash Instruments	Note 6
Derivatives and Hedging Activities	Note 7
Fair Value Option	Note 8
Collateralized Agreements and Financings	Note 9
Securitization Activities	Note 10
Variable Interest Entities	Note 11
Other Assets	Note 12
Goodwill and Identifiable Intangible Assets	Note 13
Deposits	Note 14
Short-Term Borrowings	Note 15
Long-Term Borrowings	Note 16
Other Liabilities and Accrued Expenses	Note 17
Commitments, Contingencies and Guarantees	Note 18
Shareholders Equity	Note 19
Regulation and Capital Adequacy	Note 20

Earnings Per Common Share	Note 21
Transactions with Affiliated Funds	Note 22
Interest Income and Interest Expense	Note 23
Income Taxes	Note 24
Business Segments	Note 25
Credit Concentrations	Note 26
Legal Proceedings	Note 27

Consolidation

The firm consolidates entities in which the firm has a controlling financial interest. The firm determines whether it has a controlling financial interest in an entity by first evaluating whether the entity is a voting interest entity or a variable interest entity (VIE).

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 power to direct the activities of the entity that most significantly impact its economic performance, the obligation to absorb the losses of the entity and the right to receive the residual returns of the entity. The usual condition for a controlling financial interest in a voting interest entity is ownership of a majority voting interest. If the firm has a majority voting interest in a voting interest entity, the entity is consolidated.

Variable Interest Entities. A VIE is an entity that lacks one or more of the characteristics of a voting interest entity. The firm has a controlling financial interest in a VIE when the firm has a variable interest or interests that provide it with (i) the power to direct the activities of the VIE that most significantly impact the VIE s economic performance and (ii) the obligation to absorb losses of the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE. See Note 11 for further information about VIEs.

Equity-Method Investments. When the firm does not have a controlling financial interest in an entity but can exert significant influence over the entity s operating and financial policies, the investment is accounted for either (i) under the equity method of accounting or (ii) at fair value by electing the fair value option available under U.S. GAAP. Significant influence generally exists when the firm owns 20% to 50% of the entity s common stock or in-substance common stock.

Table of Contents

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

In general, the firm accounts for investments acquired subsequent to November 24, 2006, when the fair value option became available, at fair value. In certain cases, the firm applies the equity method of accounting to new investments that are strategic in nature or closely related to the firm s principal business activities, when the firm has a significant degree of involvement in the cash flows or operations of the investee or when cost-benefit considerations are less significant. See Note 12 for further information about equity-method investments.

Investment Funds. The firm has formed numerous investment funds with third-party investors. These funds are typically organized as limited partnerships or limited liability companies for which the firm acts as general partner or manager. Generally, the firm does not hold a majority of the economic interests in these funds. These funds are usually voting interest entities and generally are not consolidated because third-party investors typically have rights to terminate the funds or to remove the firm as general partner or manager. Investments in these funds are included in Financial instruments owned, at fair value. See Notes 6, 18 and 22 for further information about investments in funds.

Use of Estimates

Preparation of these condensed consolidated financial statements requires management to make certain estimates and assumptions, the most important of which relate to fair value measurements, accounting for goodwill and identifiable intangible assets, discretionary compensation accruals and the provision for losses that may arise from litigation, regulatory proceedings and tax audits. These estimates and assumptions are based on the best available information but actual results could be materially different.

Revenue Recognition

Financial Assets and Financial Liabilities at Fair Value. Financial instruments owned, at fair value and Financial instruments sold, but not yet purchased, at fair value are recorded at fair value either under the fair value option or in accordance with other U.S. GAAP. In addition, the firm has elected to account for certain of its other financial assets and financial liabilities at fair value by electing the fair value option. 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. Financial assets are marked to bid prices and financial liabilities are marked to offer prices. Fair value measurements do not include transaction costs. Fair value gains or losses are generally included in Market making for positions in Institutional Client Services and Other principal transactions for positions in Investing & Lending. See Notes 5 through 8 for further information about fair value measurements.

Investment Banking. Fees from financial advisory assignments and underwriting revenues are recognized in earnings when the services related to the underlying transaction are completed under the terms of the assignment. Expenses associated with such transactions are deferred until the related revenue is recognized or the assignment is otherwise concluded. Expenses associated with financial advisory assignments are recorded as non-compensation expenses, net of client reimbursements. Underwriting revenues are presented net of related expenses.

Investment Management. The firm earns management fees and incentive fees for investment management services. Management fees are calculated as a percentage of net asset value, invested capital or commitments, and are recognized over the period that the related service is provided. Incentive fees are calculated as a percentage of a fund s or separately managed account s return, or excess return above a specified benchmark or other performance target. Incentive fees are generally based on investment performance over a 12-month period or over the life of a fund. Fees that are based on performance over a 12-month period are subject to adjustment prior to the end of the measurement period. For fees that are based on investment performance over the life of the fund, future investment underperformance may require fees previously distributed to the firm to be returned to the fund. Incentive fees are recognized only when all material contingencies have been resolved. Management and incentive fee revenues are included in Investment management revenues.

Commissions and Fees. The firm earns Commissions and fees from executing and clearing client transactions on stock, options and futures markets. Commissions and fees are recognized on the day the trade is executed.

Transfers of Assets

Transfers of assets are accounted for as sales when the firm has relinquished control over the assets transferred. For transfers of assets accounted for as sales, any related gains or losses are recognized in net revenues. Assets or liabilities that arise from the firm s continuing involvement with transferred assets are measured at fair value. For transfers of assets that are not accounted for as sales, the assets remain in Financial instruments owned, at fair value and the transfer is accounted for as a collateralized financing, with the related interest expense recognized over the life of the transaction. See Note 9 for further information about transfers of assets accounted for as collateralized financings and Note 10 for further information about transfers of assets accounted for as sales.

Receivables from Customers and Counterparties

Receivables from customers and counterparties generally relate to collateralized transactions. Such receivables are primarily comprised of customer margin loans, transfers of assets accounted for as secured loans rather than purchases and collateral posted in connection with certain derivative transactions. Certain of the firm s receivables from customers and counterparties are accounted for at fair value under the fair value option, with changes in fair value generally included in Market making revenues. See Note 8 for further information about the fair values of these receivables. Receivables from customers and counterparties not accounted for at fair value are accounted for at amortized cost net of estimated uncollectible amounts. Interest on receivables from customers and counterparties is recognized over the life of the transaction and included in Interest income.

Insurance Activities

Certain of the firm's insurance and reinsurance contracts are accounted for at fair value under the fair value option, with changes in fair value included in Market making revenues. See Note 8 for further information about the fair values of these insurance and reinsurance contracts.

Revenues from variable annuity and life insurance and reinsurance contracts not accounted for at fair value generally consist of fees assessed on contract holder account balances for mortality charges, policy administration fees and surrender charges. These revenues are recognized in earnings over the period that services are provided and are included in Market making revenues. Changes in reserves, including interest credited to policyholder account balances, are recognized in Insurance reserves.

Premiums earned for underwriting property catastrophe reinsurance are recognized in earnings over the coverage period, net of premiums ceded for the cost of reinsurance, and are included in Market making revenues. Expenses for liabilities related to property catastrophe reinsurance claims, including estimates of losses that have been incurred but not reported, are included in Insurance reserves.

Share-based Compensation

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 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 pays cash dividend equivalents on outstanding restricted stock units (RSUs). Dividend equivalents paid on RSUs are generally charged to retained earnings. Dividend equivalents paid on RSUs expected to be forfeited are included in compensation expense. The firm accounts for the tax benefit related to dividend equivalents paid on RSUs as an increase to additional paid-in capital.

In certain cases, primarily related to 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.

Table of Contents

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

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 statements of financial condition and revenues and expenses are translated at average rates of exchange for the period. Foreign currency remeasurement gains or losses on transactions in nonfunctional currencies are recognized in earnings. 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.

Cash and Cash Equivalents

The firm defines cash equivalents as highly liquid overnight deposits held in the ordinary course of business. As of March 2012 and December 2011, Cash and cash equivalents included $7.22 billion and $7.95 billion, respectively, of cash and due from banks, and $49.92 billion and $48.05 billion, respectively, of interest-bearing deposits with banks.

Recent Accounting Developments

Reconsideration of Effective Control for Repurchase Agreements (ASC 860). In April 2011, the FASB issued ASU No. 2011-03, Transfers and Servicing (Topic 860) Reconsideration of Effective Control for Repurchase Agreements. ASU No. 2011-03 changes the assessment of effective control by removing (i) the criterion that requires the transferor to have the ability to repurchase or redeem financial assets on substantially the agreed terms, even in the event of default by the transferee, and (ii) the collateral maintenance implementation guidance related to that criterion. ASU No. 2011-03 is effective for periods beginning after December 15, 2011. The firm adopted the standard on January 1, 2012. Adoption of ASU No. 2011-03 did not affect the firm s financial condition, results of operations or cash flows.

Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs (ASC 820). In May 2011, the FASB issued ASU No. 2011-04, Fair Value Measurements and Disclosures (Topic 820) Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. ASU No. 2011-04 clarifies the application of existing fair value measurement and disclosure requirements, changes certain principles related to measuring fair value, and requires additional disclosures about fair value measurements. ASU No. 2011-04 is effective for periods beginning after December 15, 2011. The firm adopted the standard on January 1, 2012. Adoption of ASU No. 2011-04 did not materially affect the firm s financial condition, results of operations or cash flows.

Derecognition of in Substance Real Estate (ASC 360). In December 2011, the FASB issued ASU No. 2011-10, Property, Plant, and Equipment (Topic 360) Derecognition of in Substance Real Estate a Scope Clarification. ASU No. 2011-10 clarifies that in order to deconsolidate a subsidiary (that is in substance real estate) as a result of a parent no longer controlling the subsidiary due to a default on the subsidiary s nonrecourse debt, the parent also must satisfy the sale criteria in ASC 360-20, Property, Plant, and Equipment Real Estate Sales. The ASU is effective for fiscal years beginning on or after June 15, 2012. The firm will apply the provisions of the ASU to such events occurring on or after January 1, 2013. Adoption is not expected to materially affect the firm s financial condition, results of operations or cash flows.

Disclosures about Offsetting Assets and Liabilities (ASC 210). In December 2011, the FASB issued ASU No. 2011-11, Balance Sheet (Topic 210) Disclosures about Offsetting Assets and Liabilities. ASU No. 2011-11 will require disclosure of the effect or potential effect of offsetting arrangements on the firm s financial position as well as enhanced disclosure of the rights of setoff associated with the firm s recognized assets and recognized liabilities. ASU No. 2011-11 is effective for periods beginning on or after January 1, 2013. Since these amended principles require only additional disclosures concerning offsetting and related arrangements, adoption will not affect the firm s financial condition, results of operations or cash flows.

Table of Contents

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Note 4. Financial Instruments Owned, at Fair Value and Financial Instruments Sold, But Not Yet Purchased, at Fair Value

Note 4.

Financial Instruments Owned, at Fair Value and Financial Instruments Sold, But Not Yet Purchased, at Fair Value

Financial instruments owned, at fair value and financial instruments sold, but not yet purchased, at fair value are accounted for at fair value either under the fair value option or in accordance with other U.S. GAAP. See Note 8 for further information about the fair value option. The table below presents 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. Financial instruments owned, at fair value included $4.69 billion and $4.86 billion as of March 2012 and December 2011, respectively, of securities accounted for as available-for-sale, substantially all of which are held in the firm s insurance subsidiaries.

	As of March 2012		As of December 2011	
in millions	**Financial Instruments Owned**	**Financial Instruments Sold, But Not Yet Purchased**	Financial Instruments Owned	Financial Instruments Sold, But Not Yet Purchased
Commercial paper, certificates of deposit, time deposits and other money market instruments	**$ 10,553**	**$**	$ 13,440	$
U.S. government and federal agency obligations	**90,488**	**27,489**	87,040	21,006
Non-U.S. government obligations	**60,812**	**43,791**	49,205	34,886
Mortgage and other asset-backed loans and securities:				
Loans and securities backed by commercial real estate	**6,724**	**1**	6,699	27
Loans and securities backed by residential real estate	**8,815**	**7**	7,592	3
Bank loans and bridge loans	**18,988**	**2,242** [2]	19,745	2,756 [2]
Corporate debt securities	**24,370**	**6,841**	22,131	6,553
State and municipal obligations	**3,407**	**47**	3,089	3
Other debt obligations	**4,702**		4,362	
Equities and convertible debentures	**75,927**	**19,483**	65,113	21,326

Commodities	**9,462**		5,762	
Derivatives [1]	**71,258**	**51,350**	80,028	58,453
Total	**$385,506**	**$151,251**	$364,206	$145,013

1. Net of cash collateral received or posted under credit support agreements and reported on a net-by-counterparty basis when a legal right of setoff exists under an enforceable netting agreement.

2. Includes the fair value of unfunded lending commitments for which the fair value option was elected.

Gains and Losses from Market Making and Other Principal Transactions

The table below presents, by major product type, the firm s Market making and Other principal transactions revenues. These gains/(losses) are primarily related to the firm s financial instruments owned, at fair value and financial instruments sold, but not yet purchased, at fair value, including both derivative and non-derivative financial instruments. These gains/(losses) exclude related interest income and interest expense. See Note 23 for further information about interest income and interest expense.

The gains/(losses) in the table are not representative of the manner in which the firm manages its business activities because many of the firm s market-making, client facilitation, and investing and lending strategies utilize financial instruments across various product types. Accordingly, gains or losses in one product type frequently offset gains or losses in other product types. For example, most of the firm s longer-term derivatives are sensitive to changes in interest rates and may be economically hedged with interest rate swaps. Similarly, a significant portion of the firm s cash instruments and derivatives has exposure to foreign currencies and may be economically hedged with foreign currency contracts.

	Three Months Ended March	
in millions	**2012**	2011
Interest rates	**$1,889**	$ 2,406
Credit	**1,710**	2,051
Currencies	**(724)**	(1,606)
Equities	**1,973**	2,850
Commodities	**471**	957
Other	**524**	416
Total	**$5,843**	$ 7,074

Note 5. Fair Value Measurements

Note 5.

Fair Value Measurements

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. Financial assets are marked to bid prices and financial liabilities are marked to offer prices. Fair value measurements do not include transaction costs. The firm measures certain financial assets and financial liabilities as a portfolio (i.e., based on its net exposure to market and/or credit risks).

The best evidence of fair value is a quoted price in an active market. If quoted prices in active markets are not available, fair value is determined by reference to prices for similar instruments, quoted prices or recent transactions in less active markets, or internally developed models that primarily use market-based or independently sourced parameters as inputs including, but not limited to, interest rates, volatilities, equity or debt prices, foreign exchange rates, commodities prices, credit spreads and funding spreads.

U.S. GAAP has a three-level fair value hierarchy for disclosure of fair value measurements. The fair value hierarchy prioritizes inputs to the valuation techniques used to measure fair value, giving the highest priority to level 1 inputs and the lowest priority to level 3 inputs. A financial instrument s level in the fair value hierarchy is based on the lowest level of input that is significant to its fair value measurement.

The fair value hierarchy is as follows:

Level 1. Inputs are unadjusted quoted prices in active markets to which the firm had access at the measurement date for identical, unrestricted assets or liabilities.

Level 2. Inputs to valuation techniques are observable, either directly or indirectly.

Level 3. One or more inputs to valuation techniques are significant and unobservable.

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

The fair values for substantially all of the firm s financial assets and financial liabilities are based on observable prices and inputs and are classified in levels 1 and 2 of the hierarchy. Certain level 2 and level 3 financial assets and financial liabilities may require appropriate valuation adjustments that a market participant would require to arrive at fair value for factors such as counterparty and the firm s credit quality, funding risk, transfer restrictions, liquidity and bid/offer spreads. Valuation adjustments are generally based on market evidence.

See Notes 6 and 7 for further information about fair value measurements of cash instruments and derivatives, respectively, included in Financial instruments owned, at fair value and Financial instruments sold, but not yet purchased, at fair value, and Note 8 for further information about fair value measurements of other financial assets and financial liabilities accounted for at fair value under the fair value option.

Financial assets and financial liabilities accounted for at fair value under the fair value option or in accordance with other U.S. GAAP are summarized below.

	As of	
$ in millions	**March 2012**	December 2011
Total level 1 financial assets	**$ 159,906**	$ 136,780
Total level 2 financial assets	**566,165**	587,416
Total level 3 financial assets	**48,015**	47,937
Netting and collateral [1]	**(108,461)**	(120,821)
Total financial assets at fair value	**$ 665,625**	$ 651,312
Total assets	**$ 950,932**	$ 923,225
Total level 3 financial assets as a percentage of Total assets	**5.0%**	5.2%
Total level 3 financial assets as a percentage of Total financial assets at fair value	**7.2%**	7.4%
Total level 3 financial liabilities at fair value	**$ 23,941**	$ 25,498
Total financial liabilities at fair value	**$ 403,516**	$ 388,669
Total level 3 financial liabilities as a percentage of Total financial liabilities at fair value	**5.9%**	6.6%

1. Represents the impact on derivatives of cash collateral and counterparty netting across levels of the fair value hierarchy. Netting among positions classified in the same level is included in that level.

Level 3 financial assets as of March 2012 were essentially unchanged compared with December 2011, primarily reflecting an increase in private equity investments, principally due to transfers to level 3 and purchases, offset by a decrease in derivative assets. The decrease in derivative assets primarily reflected settlements and net unrealized losses on credit and currency derivatives, partially offset by the impact of decreased counterparty netting and transfers to level 3 of certain credit derivatives.

See Notes 6, 7 and 8 for further information about level 3 cash instruments, derivatives and other financial assets and financial liabilities accounted for at fair value under the fair value option, respectively, including information about significant unrealized gains or losses and transfers in or out of level 3.

Table of Contents

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Note 6. Cash Instruments

Note 6.

Cash Instruments

Cash instruments include U.S. government and federal agency obligations, non-U.S. government obligations, bank loans and bridge loans, corporate debt securities, equities and convertible debentures, and other non-derivative financial instruments owned and financial instruments sold, but not yet purchased. See below for the types of cash instruments included in each level of the fair value hierarchy and the valuation techniques and significant inputs used to determine their fair values. See Note 5 for an overview of the firm s fair value measurement policies.

Level 1 Cash Instruments

Level 1 cash instruments include U.S. government obligations and most non-U.S. government obligations, actively traded listed equities and certain government agency obligations and money market instruments. These instruments are valued using quoted prices for identical unrestricted instruments in active markets.

The firm defines active markets for equity instruments based on the average daily trading volume both in absolute terms and relative to the market capitalization for the instrument. The firm defines active markets for debt instruments based on both the average daily trading volume and the number of days with trading activity.

Level 2 Cash Instruments

Level 2 cash instruments include commercial paper, certificates of deposit, time deposits, most government agency obligations, certain non-U.S. government obligations, most corporate debt securities, commodities, certain mortgage-backed loans and securities, certain bank loans and bridge loans, restricted or less liquid listed equities, most state and municipal obligations and certain lending commitments.

Valuations of level 2 cash instruments can be verified to quoted prices, recent trading activity for identical or similar instruments, broker or dealer quotations or alternative pricing sources with reasonable levels of price transparency. Consideration is given to the nature of the quotations (e.g., indicative or firm) and the relationship of recent market activity to the prices provided from alternative pricing sources.

Valuation adjustments are typically made to level 2 cash instruments (i) if the cash instrument is subject to transfer restrictions and/or (ii) for other premiums and liquidity discounts that a market participant would require to arrive at fair value. Valuation adjustments are generally based on market evidence.

Level 3 Cash Instruments

Level 3 cash instruments have one or more significant valuation inputs that are not observable. Absent evidence to the contrary, level 3 cash instruments are initially valued at transaction price, which is considered to be the best initial estimate of fair value. Subsequently, the firm uses other methodologies to determine fair value, which vary based on the type of instrument. Valuation inputs and assumptions are changed when corroborated by substantive observable evidence, including values realized on sales of level 3 financial assets.

Table of Contents

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

The table below presents the valuation techniques and the nature of significant inputs generally used to determine the fair values of each type of level 3 cash instrument.

Level 3 Cash Instrument	Valuation Techniques and Significant Inputs
Loans and securities backed by commercial real estate	Valuation techniques vary by instrument, but are generally based on discounted cash flow techniques.
Collateralized by a single commercial real estate property or a portfolio of properties	Significant inputs for these valuations, which may be determined based on relative value analyses, include:
May include tranches of varying levels of subordination	Transaction prices in both the underlying collateral and instruments with the same or similar underlying collateral
	Market yields implied by transactions of similar or related assets and/or current levels and changes in market indices such as the CMBX (an index that tracks the performance of commercial mortgage bonds)
	Recovery rates implied by the value of the underlying collateral, which is mainly driven by current performance of the underlying collateral, capitalization rates and multiples
	Timing of expected future cash flows (duration)
Loans and securities backed by residential real estate	Valuation techniques vary by instrument, but are generally based on discounted cash flow techniques.
Collateralized by portfolios of residential real estate	Significant inputs are determined based on relative value analyses, which incorporate comparisons to instruments with similar collateral and risk profiles, including relevant indices such as the ABX (an index that tracks the performance of subprime residential mortgage bonds). Significant inputs include:

May include tranches of varying levels of subordination	Transaction prices in both the underlying collateral and instruments with the same or similar underlying collateral
	Market yields implied by transactions of similar or related assets
	Cumulative loss expectations, driven by default rates, home price projections, residential property liquidation timelines and related costs
	Duration, driven by underlying loan prepayment speeds and residential property liquidation timelines
Bank loans and bridge loans	Valuation techniques vary by instrument, but are generally based on discounted cash flow techniques.
	Significant inputs are generally determined based on relative value analyses, which incorporate comparisons both to prices of credit default swaps that reference the same or similar underlying instrument or entity and to other debt instruments for the same issuer for which observable prices or broker quotations are available. Significant inputs include:
	Market yields implied by transactions of similar or related assets and/or current levels and trends of market indices such as CDX and LCDX (indices that track the performance of corporate credit and loans, respectively)
	Current performance and recovery assumptions and, where the firm uses credit default swaps to value the related cash instrument, the cost of borrowing the underlying reference obligation
	Duration
Corporate debt securities	Valuation techniques vary by instrument, but are generally based on discounted cash flow techniques.
State and municipal obligations	Significant inputs are generally determined based on relative value analyses, which incorporate comparisons both to prices of credit default swaps that reference the same or similar underlying instrument or entity and to other debt instruments for the same issuer for which observable prices or broker quotations are available. Significant inputs include:

Non-U.S. government obligations Other debt obligations	Market yields implied by transactions of similar or related assets and/or current levels and trends of market indices such as CDX, LCDX and MCDX (an index that tracks the performance of municipal obligations) Current performance and recovery assumptions and, where the firm uses credit default swaps to value the related cash instrument, the cost of borrowing the underlying reference obligation Duration
Equities and convertible debentures Private equity investments (including investments in real estate entities)	Recent third-party completed or pending transactions (e.g., merger proposals, tender offers, debt restructurings) are considered to be the best evidence for any change in fair value. When these are not available, the following valuation methodologies are used, as appropriate and available: Industry multiples and public comparables Transactions in similar instruments Discounted cash flow techniques Third-party appraisals The firm also considers changes in the outlook for the relevant industry and financial performance of the issuer as compared to projected performance. Significant inputs include: Market and transaction multiples Discount rates, long-term growth rates, earnings compound annual growth rates and capitalization rates For equity instruments with debt-like features: market yields implied by transactions of similar or related assets, current performance and recovery assumptions, and duration

16

Table of Contents

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Significant Unobservable Inputs

The table below presents the ranges of significant unobservable inputs used to value the firm s level 3 cash instruments. These ranges represent the significant unobservable inputs that were used in the valuation of each type of cash instrument. These inputs are not representative of the inputs that could have been used in the valuation of any one cash instrument. For example, the highest multiple

presented in the table for private equity investments is appropriate for valuing a specific private equity investment but may not be appropriate for valuing any other private equity investment. Accordingly, the ranges of inputs presented below do not represent uncertainty in, or possible ranges of, fair value measurements of the firm s level 3 cash instruments.

Level 3 Cash Instrument	Significant Unobservable Inputs by Valuation Technique	Range of Significant Unobservable Inputs as of March 2012
Loans and securities backed by commercial real estate	Discounted cash flows:	
Collateralized by a single commercial real estate property or a portfolio of properties	Yield	3.3% to 27.7%
	Recovery rate [1]	20.0% to 100.0%
May include tranches of varying levels of subordination	Duration (years) [2]	0.6 to 7.4
Loans and securities backed by residential real estate	Discounted cash flows:	
Collateralized by portfolios of residential real estate	Yield	3.2% to 30.0%
May include tranches of varying levels of subordination	Cumulative loss rate	0.0% to 79.0%
		0.1 to 9.7

	Duration (years)[3]	
Bank loans and bridge loans	Discounted cash flows:	
	Yield	0.7% to 28.1%
	Recovery rate[1]	15.0% to 100.0%
	Duration (years)[3]	0.5 to 7.9
Corporate debt securities	Discounted cash flows:	
State and municipal obligations	Yield	1.5% to 35.3%
Non-U.S. government obligations	Recovery rate[1]	0.0% to 100.0%
Other debt obligations	Duration (years)[3]	0.4 to 18.0
Equities and convertible debentures	Comparable multiples:	
Private equity investments (including investments in real estate entities)	Multiples	0.8x to 20.0x
	Discounted cash flows:	
	Yield/discount rate	10.0% to 30.0%
	Long-term growth rate/compound annual growth rate	(0.7)% to 55.9%

	Capitalization rate	5.5% to 11.5%
	Recovery rate[1]	45.0% to 100.0%
	Duration (years)[2]	1.0 to 9.0

1. A measure of expected future cash flows, expressed as a percentage of notional or face value of the instrument.

2. Duration is an estimate of the timing of future cash flows and, in certain cases, may incorporate the impact of other unobservable inputs (e.g., prepayment speeds).

Increases in yield, discount rate, capitalization rate, duration or cumulative loss rate used in the valuation of the firm s level 3 cash instruments would result in a lower fair value measurement; while increases in recovery rate, multiples, long-term growth rate or compound annual

growth rate would result in a higher fair value measurement. Due to the distinctive nature of each of the firm s level 3 cash instruments, the interrelationship of inputs is not necessarily uniform within each product type.

17

Table of Contents

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Fair Value of Cash Instruments by Level

The tables below present, by level within the fair value hierarchy, cash instrument assets and liabilities, at fair value. Cash instrument assets and liabilities are included in

Financial instruments owned, at fair value and Financial instruments sold, but not yet purchased, at fair value, respectively.

	Cash Instrument Assets at Fair Value as of March 2012			
in millions	**Level 1**	**Level 2**	**Level 3**	**Total**
Commercial paper, certificates of deposit, time deposits and other money market instruments	**$ 1,985**	**$ 8,560**	**$ 8**	**$ 10,553**
U.S. government and federal agency obligations	**37,228**	**53,260**		**90,488**
Non-U.S. government obligations	**47,657**	**13,050**	**105**	**60,812**
Mortgage and other asset-backed loans and securities [1]:				
Loans and securities backed by commercial real estate		**3,568**	**3,156**	**6,724**
Loans and securities backed by residential real estate		**7,205**	**1,610**	**8,815**
Bank loans and bridge loans		**7,937**	**11,051**	**18,988**
Corporate debt securities [2]	**90**	**21,768**	**2,512**	**24,370**
State and municipal obligations		**2,795**	**612**	**3,407**
Other debt obligations [2]		**3,153**	**1,549**	**4,702**
Equities and convertible debentures	**48,535** [3]	**12,518** [4]	**14,874** [5]	**75,927**
Commodities		**9,462**		**9,462**
Total	**$135,495**	**$143,276**	**$35,477**	**$314,248**

	Cash Instrument Liabilities at Fair Value as of March 2012			
in millions	**Level 1**	**Level 2**	**Level 3**	**Total**
U.S. government and federal agency obligations	**$ 27,289**	**$ 200**	**$**	**$ 27,489**
Non-U.S. government obligations	**43,255**	**536**		**43,791**
Mortgage and other asset-backed loans and securities:				
Loans and securities backed by commercial real estate		**1**		**1**
Loans and securities backed by residential real estate		**7**		**7**
Bank loans and bridge loans		**1,519**	**723**	**2,242**
Corporate debt securities [6]	**9**	**6,816**	**16**	**6,841**
State and municipal obligations		**47**		**47**
Equities and convertible debentures	**18,489** [3]	**986** [4]	**8**	**19,483**
Total	**$ 89,042**	**$ 10,112**	**$ 747**	**$ 99,901**

1. Includes $437 million and $590 million of collateralized debt obligations (CDOs) backed by real estate in level 2 and level 3, respectively.

2. Includes $404 million and $1.40 billion of CDOs and collateralized loan obligations (CLOs) backed by corporate obligations in level 2 and level 3, respectively.

3. Consists of listed equity securities.

4. Principally consists of restricted or less liquid listed securities.

5. Includes $13.05 billion of private equity investments, $1.23 billion of real estate investments and $592 million of convertible debentures.

6. Includes $7 million of CDOs and CLOs backed by corporate obligations in level 3.

Table of Contents

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

	Cash Instrument Assets at Fair Value as of December 2011			
in millions	Level 1	Level 2	Level 3	Total
Commercial paper, certificates of deposit, time deposits and other money market instruments	$ 3,255	$ 10,185	$	$ 13,440
U.S. government and federal agency obligations	29,263	57,777		87,040
Non-U.S. government obligations	42,854	6,203	148	49,205
Mortgage and other asset-backed loans and securities [1]:				
Loans and securities backed by commercial real estate		3,353	3,346	6,699
Loans and securities backed by residential real estate		5,883	1,709	7,592
Bank loans and bridge loans		8,460	11,285	19,745
Corporate debt securities [2]	133	19,518	2,480	22,131
State and municipal obligations		2,490	599	3,089
Other debt obligations [2]		2,911	1,451	4,362
Equities and convertible debentures	39,955 [3]	11,491 [4]	13,667 [5]	65,113
Commodities		5,762		5,762
Total	$115,460	$134,033	$34,685	$284,178

	Cash Instrument Liabilities at Fair Value as of December 2011			
in millions	Level 1	Level 2	Level 3	Total
U.S. government and federal agency obligations	$ 20,940	$ 66	$	$ 21,006
Non-U.S. government obligations	34,339	547		34,886
Mortgage and other asset-backed loans and securities:				
Loans and securities backed by commercial real estate		27		27
Loans and securities backed by residential real estate		3		3
Bank loans and bridge loans		1,891	865	2,756
Corporate debt securities [6]		6,522	31	6,553
State and municipal obligations		3		3
Equities and convertible debentures	20,069 [3]	1,248 [4]	9	21,326
Total	$ 75,348	$ 10,307	$ 905	$ 86,560

1. Includes $213 million and $595 million of collateralized debt obligations (CDOs) backed by real estate in level 2 and level 3, respectively.

2. Includes $403 million and $1.19 billion of CDOs and collateralized loan obligations (CLOs) backed by corporate obligations in level 2 and level 3, respectively.

3. Consists of listed equity securities.

4. Principally consists of restricted or less liquid listed securities.

5. Includes $12.07 billion of private equity investments, $1.10 billion of real estate investments and $497 million of convertible debentures.

6. Includes $27 million of CDOs and CLOs backed by corporate obligations in level 3.

Transfers Between Levels of the Fair Value Hierarchy

Transfers between levels of the fair value hierarchy are reported at the beginning of the reporting period in which they occur. Transfers of cash instruments between level 1 and level 2 were $728 million for the three months ended March 2012, consisting of transfers to level 2 of public

equity investments, primarily reflecting the impact of transfer restrictions. See level 3 rollforwards below for further information about transfers between level 2 and level 3.

Table of Contents

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Level 3 Rollforward

If a cash instrument asset or liability was transferred to level 3 during a reporting period, its entire gain or loss for the period is included in level 3.

Level 3 cash instruments are frequently economically hedged with level 1 and level 2 cash instruments and/or level 1, level 2 or level 3 derivatives. Accordingly, gains or losses that are reported in level 3 can be partially offset by gains or losses attributable to level 1 or level 2 cash

instruments and/or level 1, level 2 or level 3 derivatives. As a result, gains or losses included in the level 3 rollforward below do not necessarily represent the overall impact on the firm s results of operations, liquidity or capital resources.

The tables below present changes in fair value for all cash instrument assets and liabilities categorized as level 3 as of the end of the period.

	Level 3 Cash Instrument Assets at Fair Value for the Three Months Ended March 2012								
in millions	Balance, beginning of period	Net realized gains/ (losses)	Net unrealized gains/(losses) relating to instruments still held at period-end	Purchases [1]	Sales	Settlements	Transfers into level 3	Transfers out of level 3	Balance, end of period
Commercial paper, certificates of deposit, time deposits and other money market instruments	$	$	$	$ 8	$	$	$	$	$ 8
Non-U.S. government obligations	148	(1)	(59)	7	(8)		20	(2)	105
Mortgage and other asset-backed loans and securities:									
Loans and securities backed by commercial real estate	3,346	39	96	295	(276)	(289)	486	(541)	3,156
Loans and securities backed by residential real estate	1,709	43	23	254	(181)	(101)	14	(151)	1,610
Bank loans and bridge loans	11,285	150	206	1,188	(1,246)	(792)	960	(700)	11,051
Corporate debt securities	2,480	92	158	295	(422)	(128)	260	(223)	2,512
State and municipal obligations	599	2	8	20	(39)	(2)	25	(1)	612
Other debt obligations	1,451	44	24	99	(120)	(56)	123	(16)	1,549
Equities and convertible debentures	13,667	39	332	558	(150)	(194)	779	(157)	14,874
Total	$34,685	$408 [2]	$788 [2]	$2,724	$(2,442)	$(1,562)	$2,667	$(1,791)	$35,477

	Level 3 Cash Instrument Liabilities at Fair Value for the Three Months Ended March 2012								
in millions	Balance, beginning of period	Net realized (gains)/ losses	Net unrealized (gains)/losses relating to instruments	Purchases	Sales	Settlements	Transfers into level 3	Transfers out of level 3	Balance, end of period

			still held at period-end						
Total	**$ 905**	**$ (34)**	**$ (68)**	**$ (326)**	**$ 87**	**$ 195**	**$ 102**	**$ (114)**	**$ 747**

1. Includes both originations and secondary market purchases.

2. The aggregate amounts include approximately $167 million, $654 million and $375 million reported in Market making, Other principal transactions and Interest income, respectively.

The net unrealized gain on level 3 cash instruments of $856 million (reflecting $788 million on cash instrument assets and $68 million on cash instrument liabilities) for the three months ended March 2012 primarily consisted of gains on private equity investments, bank loans and bridge loans, and corporate debt securities, primarily reflecting an increase in global equity prices and tighter credit spreads.

Transfers into level 3 during the three months ended March 2012 primarily reflected transfers from level 2 of certain bank loans and bridge loans, private equity

investments, and loans and securities backed by commercial real estate, principally due to reduced transparency of market prices as a result of less market activity in these instruments.

Transfers out of level 3 during the three months ended March 2012 primarily reflected transfers to level 2 of certain bank and bridge loans, and loans and securities backed by commercial real estate, principally due to improved transparency of market prices as a result of market activity in these instruments.

Table of Contents

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

	Level 3 Cash Instrument Assets at Fair Value for the Three Months Ended March 2011							
in millions	Balance, beginning of period	Net realized gains/ (losses)	Net unrealized gains/(losses) relating to instruments still held at period-end	Purchases [1]	Sales	Settlements	Net transfers in and/or (out) of level 3	Balance, end of period
Mortgage and other asset-backed loans and securities:								
Loans and securities backed by commercial real estate	$ 3,976	$ 58	$ 162	$ 389	$ (527)	$ (323)	$ (22)	$ 3,713
Loans and securities backed by residential real estate	2,501	50	50	575	(230)	(206)	16	2,756
Bank loans and bridge loans	9,905	169	568	491	(274)	(604)	(326)	9,929
Corporate debt securities	2,737	92	216	789	(459)	(104)	(133)	3,138
State and municipal obligations	754	1	13	7	(3)	(1)	(29)	742
Other debt obligations	1,274	24	20	297	(149)	(53)	70	1,483
Equities and convertible debentures	11,060	40	233	268	(302)	(121)	587	11,765
Total	$32,207	$434 [2]	$1,262 [2]	$2,816	$(1,944)	$(1,412)	$ 163	$33,526

	Level 3 Cash Instrument Liabilities at Fair Value for the Three Months Ended March 2011							
in millions	Balance, beginning of period	Net realized (gains)/ losses	Net unrealized (gains)/losses relating to instruments still held at period-end	Purchases	Sales	Settlements	Net transfers in and/or (out) of level 3	Balance, end of period
Total	$ 446	$ (22)	$ 41	$ (59)	$ 90	$ 8	$ (22)	$ 482

1. Includes both originations and secondary market purchases.

2. The aggregate amounts include approximately $608 million, $656 million and $432 million reported in Market making, Other principal transactions and Interest income, respectively.

The net unrealized gain/(loss) on level 3 cash instruments of $1.22 billion (reflecting $1.26 billion on cash instrument assets and $(41) million on cash instrument liabilities) for the three months ended March 2011 primarily consisted of unrealized gains on bank loans and bridge loans, private equity investments and corporate debt securities, reflecting strengthening global credit markets and equity markets.

Significant transfers in or out of level 3 during the three months ended March 2011 included:

Bank loans and bridge loans: net transfer out of level 3 of $326 million, principally due to transfers to level 2 of certain loans due to improved transparency of market prices as a result of market transactions in these financial instruments, partially offset by transfers to level 3 of certain loans due to reduced transparency of market prices as a result of less market activity in these financial instruments.

Equities and convertible debentures: net transfer into level 3 of $587 million, principally due to transfers to level 3 of certain private equity investments due to reduced transparency of market prices as a result of less market activity in these financial instruments, partially offset by transfers to level 2 of certain equity investments due to improved transparency of market prices as a result of initial public offerings.

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Investments in Funds That Calculate Net Asset

Value Per Share

Cash instruments at fair value include investments in funds that are valued based on the net asset value per share (NAV) of the investment fund. The firm uses NAV as its measure of fair value for fund investments when (i) the fund investment does not have a readily determinable fair value and (ii) the NAV of the investment fund is calculated in a manner consistent with the measurement principles of investment company accounting, including measurement of the underlying investments at fair value.

The firm s investments in funds that calculate NAV primarily consist of investments in firm-sponsored funds where the firm co-invests with third-party investors. The private equity, private debt and real estate funds are primarily closed-end funds in which the firm s investments are not eligible for redemption. Distributions will be received from these funds as the underlying assets are liquidated and it is estimated that substantially all of the underlying assets of existing funds will be liquidated over

the next 10 years. The firm continues to manage its existing private equity funds taking into account the transition periods under the Volcker Rule of the U.S. Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), although the rules have not yet been finalized.

The firm s investments in hedge funds are generally redeemable on a quarterly basis with 91 days notice, subject to a maximum redemption level of 25% of the firm s initial investments at any quarter-end. The firm currently plans to comply with the Volcker Rule by redeeming certain of its interests in hedge funds. The firm redeemed approximately $250 million of these interests in hedge funds during the quarter ended March 2012.

The table below presents the fair value of the firm s investments in, and unfunded commitments to, funds that calculate NAV.

	As of March 2012		As of December 2011	
in millions	**Fair Value of Investments**	**Unfunded Commitments**	Fair Value of Investments	Unfunded Commitments
Private equity funds [1]	**$ 8,828**	**$3,066**	$ 8,074	$3,514
Private debt funds [2]	**3,744**	**3,244**	3,596	3,568
Hedge funds [3]	**3,058**		3,165	
Real estate funds [4]	**1,541**	**1,463**	1,531	1,613
Total	**$17,171**	**$7,773**	$16,366	$8,695

1. These funds primarily invest in a broad range of industries worldwide in a variety of situations, including leveraged buyouts, recapitalizations and growth investments.

2. These funds generally invest in loans and other fixed income instruments and are focused on providing private high-yield capital for mid- to large-sized leveraged and management buyout transactions, recapitalizations, financings, refinancings, acquisitions and restructurings for private equity firms, private family companies and corporate issuers.

3.

These funds are primarily multi-disciplinary hedge funds that employ a fundamental bottom-up investment approach across various asset classes and strategies including long/short equity, credit, convertibles, risk arbitrage, special situations and capital structure arbitrage.

4. These funds invest globally, primarily in real estate companies, loan portfolios, debt recapitalizations and direct property.

Note 7. Derivatives and Hedging Activities

Note 7.

Derivatives and Hedging Activities

Derivative Activities

Derivatives are instruments that derive their value from underlying asset prices, indices, reference rates and other inputs, or a combination of these factors. Derivatives may be privately negotiated contracts, which are usually referred to as over-the-counter (OTC) derivatives, or they may be listed and traded on an exchange (exchange-traded).

Market-Making. As a market maker, the firm enters into derivative transactions with clients and other market participants to provide liquidity and to facilitate the transfer and hedging of risk. In this capacity, the firm typically acts as principal and is consequently required to commit capital to provide execution. As a market maker, it is essential to maintain an inventory of financial instruments sufficient to meet expected client and market demands.

Risk Management. The firm also enters into derivatives to actively manage risk exposures that arise from market-making and investing and lending activities in derivative and cash instruments. The firm s holdings and exposures are hedged, in many cases, on either a portfolio or risk-specific basis, as opposed to an instrument-by-instrument basis. The offsetting impact of this economic hedging is reflected in the same business segment as the related revenues. In addition, the firm may enter into derivatives designated as hedges under U.S. GAAP. These derivatives are used to manage foreign currency exposure on the net investment in certain non-U.S. operations and to manage interest rate exposure in certain fixed-rate unsecured long-term and short-term borrowings, and certificates of deposit.

The firm enters into various types of derivatives, including:

- **Futures and Forwards.** Contracts that commit counterparties to purchase or sell financial instruments, commodities or currencies in the future.

- **Swaps.** Contracts that require counterparties to exchange cash flows such as currency or interest payment streams. The amounts exchanged are based on the specific terms of the contract with reference to specified rates, financial instruments, commodities, currencies or indices.

- **Options.** Contracts in which the option purchaser has the right, but not the obligation, to purchase from or sell to the option writer financial instruments, commodities or currencies within a defined time period for a specified price.

Derivatives are accounted for at fair value, net of cash collateral received or posted under credit support agreements. Derivatives are reported on a net-by-counterparty basis (i.e., the net payable or receivable for derivative assets and liabilities for a given counterparty) when a legal right of setoff exists under an enforceable netting agreement. Derivative assets and liabilities are included in Financial instruments owned, at fair value and Financial instruments sold, but not yet purchased, at fair value, respectively.

Substantially all gains and losses on derivatives not designated as hedges under ASC 815 are included in "Market making" and "Other principal transactions."

Table of Contents

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

The table below presents the fair value of derivatives on a net-by-counterparty basis.

	As of March 2012		As of December 2011	
in millions	**Derivative Assets**	**Derivative Liabilities**	Derivative Assets	Derivative Liabilities
Exchange-traded	**$ 5,379**	**$ 3,878**	$ 5,880	$ 3,172
Over-the-counter	**65,879**	**47,472**	74,148	55,281
Total	**$71,258**	**$51,350**	$80,028	$58,453

The table below presents the fair value and the number of derivative contracts by major product type on a gross basis. Gross fair values in the table below exclude the effects of both netting under enforceable netting agreements and

netting of cash collateral received or posted under credit support agreements, and therefore are not representative of the firm s exposure.

	As of March 2012			As of December 2011		
in millions, except number of contracts	**Derivative Assets**	**Derivative Liabilities**	**Number of Contracts**	Derivative Assets	Derivative Liabilities	Number of Contracts
Derivatives not accounted for as hedges						
Interest rates	**$ 552,324**	**$ 512,372**	**304,937**	$ 624,189	$ 582,608	287,351
Credit	**115,065**	**97,845**	**363,617**	150,816	130,659	362,407
Currencies	**74,699**	**61,091**	**242,500**	88,654	71,736	203,205
Commodities	**36,058**	**36,959**	**85,787**	35,966	38,050	93,755
Equities	**59,623**	**51,704**	**299,762**	64,135	51,928	332,273
Subtotal	**837,769**	**759,971**	**1,296,603**	963,760	874,981	1,278,991
Derivatives accounted for as hedges						
Interest rates	**22,238**	**68**	**1,308**	21,981	13	1,125
Currencies	**64**	**48**	**75**	124	21	71
Subtotal	**22,302**	**116**	**1,383**	22,105	34	1,196
Gross fair value of derivatives	**$ 860,071**	**$ 760,087**	**1,297,986**	$ 985,865	$ 875,015	1,280,187
Counterparty netting[1]	**(682,726)**	**(682,726)**		(787,733)	(787,733)	
Cash collateral netting[2]	**(106,087)**	**(26,011)**		(118,104)	(28,829)	
Fair value included in financial instruments owned	**$ 71,258**			$ 80,028		
Fair value included in financial instruments sold, but not yet purchased		**$ 51,350**			$ 58,453	

1. Represents the netting of receivable balances with payable balances for the same counterparty under enforceable netting agreements.

2. Represents the netting of cash collateral received and posted on a counterparty basis under credit support agreements.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Valuation Techniques for Derivatives

Price transparency of derivatives can generally be characterized by product type.

Interest Rate. In general, the prices and other inputs used to value interest rate derivatives are transparent, even for long-dated contracts. Interest rate swaps and options denominated in the currencies of leading industrialized nations are characterized by high trading volumes and tight bid/offer spreads. Interest rate derivatives that reference indices, such as an inflation index, or the shape of the yield curve (e.g., 10-year swap rate vs. 2-year swap rate), are more complex and are therefore less transparent, but the prices and other inputs are generally observable.

Credit. Price transparency for credit default swaps, including both single names and baskets of credits, varies by market and underlying reference entity or obligation. Credit default swaps that reference indices, large corporates and major sovereigns generally exhibit the most price transparency. For credit default swaps with other underliers, price transparency varies based on credit rating, the cost of borrowing the underlying reference obligations, and the availability of the underlying reference obligations for delivery upon the default of the issuer. Credit default swaps that reference loans, asset-backed securities and emerging market debt instruments tend to be less transparent than those that reference corporate bonds. In addition, more complex credit derivatives, such as those sensitive to the correlation between two or more underlying reference obligations, generally have less price transparency.

Currency. Prices for currency derivatives based on the exchange rates of leading industrialized nations, including those with longer tenors, are generally transparent. The primary difference between the transparency of developed and emerging market currency derivatives is that emerging markets tend to be observable for contracts with shorter tenors.

Commodity. Commodity derivatives include transactions referenced to energy (e.g., oil and natural gas), metals (e.g., precious and base) and soft commodities (e.g., agricultural). Price transparency varies based on the underlying commodity, delivery location, tenor and product quality (e.g., diesel fuel compared to unleaded gasoline). In general, price transparency for commodity derivatives is greater for contracts with shorter tenors and contracts that are more closely aligned with major and/or benchmark commodity indices.

Equity. Price transparency for equity derivatives varies by market and underlier. Options on indices and the common stock of corporates included in major equity indices exhibit the most price transparency. Equity derivatives generally have observable market prices, except for contracts with long tenors or reference prices that differ significantly from current market prices. More complex equity derivatives, such as those sensitive to the correlation between two or more individual stocks, generally have less price transparency.

Liquidity is essential to observability of all product types. If transaction volumes decline, previously transparent prices and other inputs may become unobservable. Conversely, even highly structured products may at times have trading volumes large enough to provide observability of prices and other inputs. See Note 5 for an overview of the firm s fair value measurement policies.

Level 1 Derivatives

Level 1 derivatives include short-term contracts for future delivery of securities when the underlying security is a level 1 instrument, and exchange-traded derivatives if they are actively traded and are valued at their quoted market price.

Level 2 Derivatives

Level 2 derivatives include exchange-traded derivatives that are not actively traded and OTC derivatives for which all significant valuation inputs are corroborated by market evidence.

Level 2 exchange-traded derivatives are valued using models that calibrate to market-clearing levels of OTC derivatives. Inputs to the valuations of level 2 OTC derivatives can be verified to market transactions, broker or dealer quotations or other alternative pricing sources with reasonable levels of price transparency. Consideration is given to the nature of the quotations (e.g., indicative or firm) and the relationship of recent market activity to the prices provided from alternative pricing sources.

Where models are used, the selection of a particular model to value an OTC derivative depends on the contractual terms of and specific risks inherent in the instrument, as well as the availability of pricing information in the market. Valuation models require a variety of inputs, including contractual terms, market prices, yield curves, credit curves, measures of volatility, prepayment rates, loss severity rates and correlations of such inputs. For OTC derivatives that trade in liquid markets, model selection does not involve significant management judgment because outputs of models can be calibrated to market-clearing levels.

Table of Contents

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Level 3 Derivatives

Level 3 OTC derivatives are valued using models which utilize observable level 1 and/or level 2 inputs, as well as unobservable level 3 inputs.

For the majority of the firm s interest rate and currency derivatives classified within level 3, the significant unobservable inputs are correlations of certain currencies and interest rates (e.g., the correlation between Euro inflation and Euro interest rates) and specific interest rate volatilities.

For level 3 credit derivatives, significant level 3 inputs include illiquid credit spreads, which are unique to specific reference obligations and reference entities, certain correlations required to value credit and mortgage derivatives (e.g., the likelihood of default of the underlying reference obligation relative to one another) and the basis, or price difference, of certain reference obligations to benchmark indices.

For level 3 equity derivatives, significant level 3 inputs generally include equity volatility inputs for options that are very long-dated and/or have strike prices that differ significantly from current market prices. In addition, the valuation of certain structured trades requires the use of level 3 inputs for the correlation of the price performance of two or more individual stocks or the correlation of the price performance for a basket of stocks to another asset class such as commodities.

For level 3 commodity derivatives, significant level 3 inputs include volatilities for options with strike prices that differ significantly from current market prices and prices or spreads for certain products for which the product quality or physical location of the commodity is not aligned with benchmark indices.

Subsequent to the initial valuation of a level 3 OTC derivative, the firm updates the level 1 and level 2 inputs to reflect observable market changes and any resulting gains and losses are recorded in level 3. Level 3 inputs are 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 by reference to market transactions, it is possible that a different valuation model could produce a materially different estimate of fair value. See below for further information about unobservable inputs used in the valuation of level 3 derivatives.

Valuation Adjustments

Valuation adjustments are integral to determining the fair value of derivatives and are used to adjust the mid-market valuations, produced by derivative pricing models, to the appropriate exit price valuation. These adjustments incorporate bid/offer spreads, the cost of liquidity, credit valuation adjustments (CVA) and funding valuation adjustments, which account for the credit and funding risk inherent in derivative portfolios. Market-based inputs are generally used when calibrating valuation adjustments to market-clearing levels.

In addition, for derivatives that include significant unobservable inputs, the firm makes model or exit price adjustments to account for the valuation uncertainty present in the transaction.

Table of Contents

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Significant Unobservable Inputs

The table below presents the ranges of significant unobservable inputs used to value the firm s level 3 derivatives. These ranges represent the significant unobservable inputs that were used in the valuation of each type of derivative. These inputs are not representative of the inputs that could have been used in the valuation of any one derivative. For example, the highest correlation presented

in the table for interest rate derivatives is appropriate for valuing a specific interest rate derivative but may not be appropriate for valuing any other interest rate derivative. Accordingly, the ranges of inputs presented below do not represent uncertainty in, or possible ranges of, fair value measurements of the firm s level 3 derivatives.

Significant Unobservable Inputs	Derivative Product Type	Range of Significant Unobservable Inputs as of March 2012	Sensitivity of Fair Value Measurement to Changes in Significant Unobservable Inputs [1]
Correlation	Interest rates	14% to 70%	For contracts where the holder benefits from the convergence of the underlying asset or index prices (e.g., interest rates, credit spreads, foreign exchange rates, inflation rates and equity prices), an increase in correlation generally results in a higher fair value measurement.
	Credit	5% to 91%	
	Currencies	66% to 87%	
	Equities	46% to 91%	
	Various [2]	(51)% to 83%	
Volatility	Interest rates	36% to 91%	In general, for purchased options an increase in volatility results in a higher fair value measurement.
	Commodities	4% to 80%	
	Equities	12% to 56%	

Credit spreads	Credit	88 basis points (bps) to 2,250 bps	In general, the fair value of purchased credit protection increases as credit spreads increase, recovery rates decrease or basis widens. Credit spreads, recovery rates and basis are strongly related to distinctive risk factors of the underlying reference obligations, which include reference entity-specific factors such as leverage, volatility and industry, market-based risk factors, such as borrowing costs or liquidity of the underlying reference obligation and macro-economic conditions.
Recovery rates	Credit	0% to 85%	
Basis	Credit	1 point to 10 points	
Spread per million British Thermal units (MMBTU) of natural gas	Commodities	$(0.82) to $3.91	For contracts where the holder is receiving a commodity, an increase in the spread (price difference from a benchmark index due to differences in quality or delivery location) generally results in a higher fair value measurement.

1. Represents the directional sensitivity of the firm s level 3 fair value measurements to changes in significant unobservable inputs, in isolation. Due to the distinctive nature of each of the firm s level 3 derivatives, the interrelationship of inputs is not necessarily uniform within each product type.

2. Represents correlation across derivative product types.

Table of Contents

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Fair Value of Derivatives by Level

The tables below present the fair value of derivatives on a gross basis by level and major product type. Gross fair values in the tables below exclude the effects of both netting under enforceable netting agreements and netting of cash

received or posted under credit support agreements both in and across levels of the fair value hierarchy, and therefore are not representative of the firm s exposure.

	Derivative Assets at Fair Value as of March 2012				
in millions	Level 1	Level 2	Level 3	Cross-Level Netting	Total
Interest rates	$149	$ 574,153	$ 260	$	$ 574,562
Credit		103,453	11,612		115,065
Currencies		73,384	1,379		74,763
Commodities		35,198	860		36,058
Equities	31	58,180	1,412		59,623
Gross fair value of derivative assets	180	844,368	15,523		860,071
Counterparty netting [1]		(675,980)	(4,372)	(2,374) [3]	(682,726)
Subtotal	$180	$ 168,388	$11,151	$(2,374)	$ 177,345
Cash collateral netting [2]					(106,087)
Fair value included in financial instruments owned					$ 71,258

	Derivative Liabilities at Fair Value as of March 2012				
in millions	Level 1	Level 2	Level 3	Cross-Level Netting	Total
Interest rates	$139	$ 511,801	$ 500	$	$ 512,440
Credit		92,735	5,110		97,845
Currencies		60,150	989		61,139
Commodities		36,000	959		36,959
Equities	33	49,739	1,932		51,704
Gross fair value of derivative liabilities	172	750,425	9,490		760,087
Counterparty netting [1]		(675,980)	(4,372)	(2,374) [3]	(682,726)
Subtotal	$172	$ 74,445	$ 5,118	$(2,374)	$ 77,361
Cash collateral netting [2]					(26,011)
Fair value included in financial instruments sold, but not yet purchased					$ 51,350

1. Represents the netting of receivable balances with payable balances for the same counterparty under enforceable netting agreements.

2. Represents the netting of cash collateral received and posted on a counterparty basis under credit support agreements.

3. Represents the netting of receivable balances with payable balances for the same counterparty across levels of the fair value hierarchy under enforceable netting agreements.

28

Table of Contents

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

	$172	**$172**	**$172**	**$172**	**$172**
		Derivative Assets at Fair Value as of December 2011			
in millions	Level 1	Level 2	Level 3	Cross-Level Netting	Total
Interest rates	$33	$ 645,923	$ 214	$	$ 646,170
Credit		137,110	13,706		150,816
Currencies		86,752	2,026		88,778
Commodities		35,062	904		35,966
Equities	24	62,684	1,427		64,135
Gross fair value of derivative assets	57	967,531	18,277		985,865
Counterparty netting [1]		(778,639)	(6,377)	(2,717) [3]	(787,733)
Subtotal	$57	$ 188,892	$11,900	$(2,717)	$ 198,132
Cash collateral netting [2]					(118,104)
Fair value included in financial instruments owned					$ 80,028

		Derivative Liabilities at Fair Value as of December 2011			
in millions	Level 1	Level 2	Level 3	Cross-Level Netting	Total
Interest rates	$ 24	$ 582,012	$ 585	$	$ 582,621
Credit		123,253	7,406		130,659
Currencies		70,573	1,184		71,757
Commodities		36,541	1,509		38,050
Equities	185	49,884	1,859		51,928
Gross fair value of derivative liabilities	209	862,263	12,543		875,015
Counterparty netting [1]		(778,639)	(6,377)	(2,717) [3]	(787,733)
Subtotal	$209	$ 83,624	$6,166	$(2,717)	$ 87,282
Cash collateral netting [2]					(28,829)
Fair value included in financial instruments sold, but not yet purchased					$ 58,453

1. Represents the netting of receivable balances with payable balances for the same counterparty under enforceable netting agreements.

2. Represents the netting of cash collateral received and posted on a counterparty basis under credit support agreements.

3. Represents the netting of receivable balances with payable balances for the same counterparty across levels of the fair value hierarchy under enforceable netting agreements.

Table of Contents

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Level 3 Rollforward

If a derivative was transferred to level 3 during a reporting period, its entire gain or loss for the period is included in level 3. Transfers between levels are reported at the beginning of the reporting period in which they occur.

Gains and losses on level 3 derivatives should be considered in the context of the following:

A derivative with level 1 and/or level 2 inputs is classified in level 3 in its entirety if it has at least one significant level 3 input.

If there is one significant level 3 input, the entire gain or loss from adjusting only observable inputs (i.e., level 1 and level 2 inputs) is classified as level 3.

Gains or losses that have been reported in level 3 resulting from changes in level 1 or level 2 inputs are frequently offset by gains or losses attributable to level 1 or level 2 derivatives and/or level 1, level 2 and level 3 cash instruments. As a result, gains/(losses) included in the level 3 rollforward below do not necessarily represent the overall impact on the firm s results of operations, liquidity or capital resources.

The tables below present changes in fair value for all derivatives categorized as level 3 as of the end of the period.

Level 3 Derivative Assets and Liabilities at Fair Value for the Three Months Ended March 2012

in millions	**Asset/ (liability) balance, beginning of period**	**Net realized gains/ (losses)**	**Net unrealized gains/(losses) relating to instruments still held at period-end**	**Purchases**	**Sales**	**Settlements**	**Transfers into level 3**	**Transfers out of level 3**	**Asset/ (liability) balance, end of period**
Interest rates net	**$ (371)**	**$(63)**	**$ 32**	**$ 3**	**$ (1)**	**$ 164**	**$ 8**	**$ (12)**	**$ (240)**
Credit net	**6,300**	**10**	**(308)**	**75**	**(73)**	**(553)**	**1,332**	**(281)**	**6,502**
Currencies net	**842**	**(6)**	**(266)**	**1**	**(7)**	**(234)**	**2**	**58** [3]	**390**
Commodities net	**(605)**	**40**	**206**	**99**	**(99)**	**41**	**100**	**119** [3]	**(99)**
Equities net	**(432)**	**(25)**	**(277)**	**73**	**(100)**	**306**	**15**	**(80)**	**(520)**
Total derivatives net	**$5,734**	**$(44)** [1]	**$(613)** [1,2]	**$251**	**$(280)**	**$(276)**	**$1,457**	**$(196)**	**$6,033**

1. The aggregate amounts include approximately $(444) million and $(213) million reported in Market making and Other principal transactions, respectively.

2. Principally resulted from changes in level 2 inputs.

3. Reflects a net transfer to level 2 of derivative liabilities.

The net unrealized loss on level 3 derivatives of $613 million for the three months ended March 2012 was primarily attributable to the impact of tighter credit spreads, increases in equity prices and changes in foreign exchange rates on the underlying derivatives, partially offset by the impact of changes in commodity prices.

Transfers into level 3 derivatives during the three months ended March 2012 primarily reflected transfers of certain credit derivative assets from level 2, primarily due to unobservable inputs becoming more significant to the valuation of these derivatives.

Transfers out of level 3 derivatives during the three months ended March 2012 primarily reflected transfers to level 2 of certain credit derivative assets, principally due to unobservable inputs no longer being significant to the valuation of these derivatives.

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Level 3 Derivative Assets and Liabilities at Fair Value for the Three Months Ended March 2011

in millions	Asset/ (liability) balance, beginning of period	Net realized gains/ (losses)	Net unrealized gains/(losses) relating to instruments still held at period-end	Purchases	Sales	Settlements	Net transfers in and/or (out) of level 3	Asset/ (liability) balance, end of period
Interest rates net	$ 194	$ (26)	$ (58)	$ 1	$	$ 13	$(221)	$ (97)
Credit net	7,040	3	(104)	70	(81)	(722)	385	6,591
Currencies net	1,098	(1)	(194)	25	(6)	(31)	241	1,132
Commodities net	220	(78)	90	241	(233)	115	(162)	193
Equities net	(990)	176	(294)	459	(625)	58	200	(1,016)
Total derivatives net	$7,562	$ 74 [1]	$(560) [1, 2]	$796	$(945)	$(567)	$443	$ 6,803

1. The aggregate amounts include approximately $(501) million and $15 million reported in Market making and Other principal transactions, respectively.

2. Principally resulted from changes in level 2 inputs.

The net unrealized loss on level 3 derivatives of $560 million for the three months ended March 2011 was primarily attributable to increases in equity index prices, tighter credit spreads and changes in foreign exchange rates on the underlying instruments.

Significant transfers in or out of level 3 derivatives during the three months ended March 2011 included:

- Credit net: net transfer to level 3 of $385 million, principally due to reduced transparency of the correlation inputs used to value certain mortgage derivatives.

Impact of Credit Spreads on Derivatives

On an ongoing basis, the firm realizes gains or losses relating to changes in credit risk through the unwind of derivative contracts and changes in credit mitigants.

The net loss, including hedges, attributable to the impact of changes in credit exposure and credit spreads (counterparty and the firm s) on derivatives was $179 million and $25 million for the three months ended March 2012 and March 2011, respectively.

Bifurcated Embedded Derivatives

The table below presents derivatives, primarily equity and interest rate products, that have been bifurcated from their related borrowings. These derivatives are recorded at fair value and included in Unsecured short-term borrowings and Unsecured long-term borrowings. See Note 8 for further information.

	As of	
	March	December
in millions, except number of contracts	**2012**	2011
Fair value of assets	**$387**	$422
Fair value of liabilities	**310**	304
Net	**$ 77**	$118
Number of contracts	**357**	333

Table of Contents

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

OTC Derivatives

The tables below present the fair values of OTC derivative assets and liabilities by tenor and by product type. Tenor is based on expected duration for mortgage-related credit

derivatives and generally on remaining contractual maturity for other derivatives.

in millions — **OTC Derivatives as of March 2012**

Assets

Product Type	**0 - 12 Months**	**1 - 5 Years**	**5 Years or Greater**	**Total**
Interest rates	$ 9,356	$31,554	$ 74,244	$ 115,154
Credit	2,705	13,987	10,976	27,668
Currencies	9,877	9,280	12,990	32,147
Commodities	5,768	4,837	124	10,729
Equities	4,306	7,620	7,370	19,296
Netting across product types [1]	(1,960)	(6,135)	(5,092)	(13,187)
Subtotal	$30,052	$61,143	$100,612	191,807
Cross maturity netting [2]				(19,841)
Cash collateral netting [3]				(106,087)
Total				$ 65,879

Liabilities

Product Type	**0 - 12 Months**	**1 - 5 Years**	**5 Years or Greater**	**Total**
Interest rates	$ 6,541	$17,077	$29,390	$ 53,008
Credit	1,222	5,826	3,400	10,448
Currencies	7,685	4,853	5,965	18,503
Commodities	5,235	4,747	2,556	12,538
Equities	3,626	4,544	3,844	12,014
Netting across product types [1]	(1,960)	(6,135)	(5,092)	(13,187)
Subtotal	$22,349	$30,912	$40,063	93,324
Cross maturity netting [2]				(19,841)
Cash collateral netting [3]				(26,011)
Total				$ 47,472

1. Represents the netting of receivable balances with payable balances for the same counterparty across product types within a tenor category under enforceable netting agreements. Receivable and payable balances with the same counterparty in the same product type and tenor category are netted within such product type and tenor category.

2. Represents the netting of receivable balances with payable balances for the same counterparty across tenor categories under enforceable netting agreements.

3. Represents the netting of cash collateral received and posted on a counterparty basis under credit support agreements.

Table of Contents

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

in millions — OTC Derivatives as of December 2011

Assets

Product Type	0 - 12 Months	1 - 5 Years	5 Years or Greater	Total
Interest rates	$10,931	$32,194	$ 82,480	$ 125,605
Credit	3,054	15,468	13,687	32,209
Currencies	11,253	11,592	16,023	38,868
Commodities	5,286	5,931	147	11,364
Equities	6,663	7,768	7,468	21,899
Netting across product types [1]	(3,071)	(6,033)	(6,027)	(15,131)
Subtotal	$34,116	$66,920	$113,778	214,814
Cross maturity netting [2]				(22,562)
Cash collateral netting [3]				(118,104)
Total				$ 74,148

Liabilities

Product Type	0 - 12 Months	1 - 5 Years	5 Years or Greater	Total
Interest rates	$ 5,787	$18,607	$37,739	$ 62,133
Credit	1,200	6,957	3,894	12,051
Currencies	9,826	5,514	6,502	21,842
Commodities	6,322	5,174	2,727	14,223
Equities	3,290	4,018	4,246	11,554
Netting across product types [1]	(3,071)	(6,033)	(6,027)	(15,131)
Subtotal	$23,354	$34,237	$49,081	106,672
Cross maturity netting [2]				(22,562)
Cash collateral netting [3]				(28,829)
Total				$ 55,281

1. Represents the netting of receivable balances with payable balances for the same counterparty across product types within a tenor category under enforceable netting agreements. Receivable and payable balances with the same counterparty in the same product type and tenor category are netted within such product type and tenor category.

2. Represents the netting of receivable balances with payable balances for the same counterparty across tenor categories under enforceable netting agreements.

3. Represents the netting of cash collateral received and posted on a counterparty basis under credit support agreements.

Table of Contents

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Derivatives with Credit-Related Contingent Features

Certain of the firm s derivatives have been transacted under bilateral agreements with counterparties who may require the firm to post collateral or terminate the transactions based on changes in the firm s credit ratings. The table below presents the aggregate fair value of net derivative liabilities under such agreements (excluding application of collateral posted to reduce these liabilities), the related aggregate fair value of the assets posted as collateral, and the additional collateral or termination payments that could have been called at the reporting date by counterparties in the event of a one-notch and two-notch downgrade in the firm s credit ratings.

	As of	
	March	December
in millions	**2012**	2011
Net derivative liabilities under bilateral agreements	**$27,370**	$35,066
Collateral posted	**22,742**	29,002
Additional collateral or termination payments for a one-notch downgrade	**1,331**	1,303
Additional collateral or termination payments for a two-notch downgrade	**2,207**	2,183

Credit Derivatives

The firm enters into a broad array of credit derivatives in locations around the world to facilitate client transactions and to manage the credit risk associated with market-making and investing and lending activities. Credit derivatives are actively managed based on the firm s net risk position.

Credit derivatives are individually negotiated contracts and can have various settlement and payment conventions. Credit events include failure to pay, bankruptcy, acceleration of indebtedness, restructuring, repudiation and dissolution of the reference entity.

Credit Default Swaps. Single-name credit default swaps protect the buyer against the loss of principal on one or more bonds, loans or mortgages (reference obligations) in the event the issuer (reference entity) of the reference obligations suffers a credit event. The buyer of protection pays an initial or periodic premium to the seller and receives protection for the period of the contract. If there is no credit event, as defined in the contract, the seller of protection makes no payments to the buyer of protection. However, if a credit event occurs, the seller of protection is required to make a payment to the buyer of protection, which is calculated in accordance with the terms of the contract.

Credit Indices, Baskets and Tranches. Credit derivatives may reference a basket of single-name credit default swaps or a broad-based index. If a credit event occurs in one of the underlying reference obligations, the protection seller pays the protection buyer. The payment is typically a pro-rata portion of the transaction s total notional amount based on the underlying defaulted reference obligation. In certain transactions, the credit risk of a basket or index is separated into various portions (tranches), each having different levels of subordination. The most junior tranches cover initial defaults and once losses exceed the notional amount of these junior tranches, any excess loss is covered by the next most senior tranche in the capital structure.

Total Return Swaps. A total return swap transfers the risks relating to economic performance of a reference obligation from the protection buyer to the protection seller. Typically, the protection buyer receives from the protection seller a floating rate of interest and protection against any reduction in fair value of the reference obligation, and in return the protection seller receives the cash flows associated with the reference obligation, plus any increase in the fair value of the reference obligation.

Credit Options. In a credit option, the option writer assumes the obligation to purchase or sell a reference obligation at a specified price or credit spread. The option purchaser buys the right, but not the obligation, to sell the reference obligation to, or purchase it from, the option writer. The payments on credit options depend either on a particular credit spread or the price of the reference obligation.

The firm economically hedges its exposure to written credit derivatives primarily by entering into offsetting purchased credit derivatives with identical underlyings. Substantially all of the firm s purchased credit derivative transactions are with financial institutions and are subject to stringent collateral thresholds. In addition, upon the occurrence of a specified trigger event, the firm may take possession of the reference obligations underlying a particular written credit derivative, and consequently may, upon liquidation of the reference obligations, recover amounts on the underlying reference obligations in the event of default.

Table of Contents

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

As of March 2012, written and purchased credit derivatives had total gross notional amounts of $1.97 trillion and $2.10 trillion, respectively, for total net notional purchased protection of $123.20 billion. As of December 2011, written and purchased credit derivatives had total gross notional amounts of $1.96 trillion and $2.08 trillion, respectively, for total net notional purchased protection of $116.93 billion.

The table below presents certain information about credit derivatives. In the table below:

fair values exclude the effects of both netting under enforceable netting agreements and netting of cash received or posted under credit support agreements, and therefore are not representative of the firm s credit exposure;

tenor is based on expected duration for mortgage-related credit derivatives and on remaining contractual maturity for other credit derivatives; and

the credit spread on the underlying, together with the tenor of the contract, are indicators of payment/performance risk. The firm is less likely to pay or otherwise be required to perform where the credit spread and the tenor are lower.

	Maximum Payout/Notional Amount of Written Credit Derivatives by Tenor				Maximum Payout/Notional Amount of Purchased Credit Derivatives		Fair Value of Written Credit Derivatives		
$ in millions	0 - 12 Months	1 - 5 Years	5 Years or Greater	Total	Offsetting Purchased Credit Derivatives [1]	Other Purchased Credit Derivatives [2]	Asset	Liability	Net Asset/ (Liability)
As of March 2012									
Credit spread on underlying (basis points)									
0-250	**$345,122**	**$ 906,230**	**$180,754**	**$1,432,106**	**$1,323,645**	**$212,487**	**$23,214**	**$ 11,569**	**$ 11,645**
251-500	**29,433**	**195,101**	**55,788**	**280,322**	**251,767**	**40,987**	**5,534**	**13,026**	**(7,492)**
501-1,000	**13,226**	**112,724**	**24,416**	**150,366**	**134,781**	**20,049**	**1,368**	**10,701**	**(9,333)**
Greater than 1,000	**19,673**	**77,527**	**12,880**	**110,080**	**91,671**	**20,690**	**488**	**35,757**	**(35,269)**
Total	**$407,454**	**$1,291,582**	**$273,838**	**$1,972,874**	**$1,801,864**	**$294,213**	**$30,604**	**$ 71,053**	**$(40,449)**
As of December 2011									
Credit spread on underlying (basis points)									
0-250	$282,851	$ 794,193	$141,688	$1,218,732	$1,122,296	$180,316	$17,572	$ 16,907	$ 665
251-500	42,682	269,687	69,864	382,233	345,942	47,739	4,517	20,810	(16,293)
501-1,000	29,377	140,389	21,819	191,585	181,003	23,176	138	15,398	(15,260)

Greater than 1,000	30,244	114,103	22,995	167,342	147,614	28,734	512	57,201	(56,689)
Total	$385,154	$1,318,372	$256,366	$1,959,892	$1,796,855	$279,965	$22,739	$110,316	$(87,577)

1. Offsetting purchased credit derivatives represent the notional amount of purchased credit derivatives to the extent they economically hedge written credit derivatives with identical underlyings.

2. This purchased protection represents the notional amount of purchased credit derivatives in excess of the notional amount included in Offsetting Purchased Credit Derivatives.

Hedge Accounting

The firm applies hedge accounting for (i) certain interest rate swaps used to manage the interest rate exposure of certain fixed-rate unsecured long-term and short-term borrowings and certain fixed-rate certificates of deposit and (ii) certain foreign currency forward contracts and foreign currency-denominated debt used to manage foreign currency exposures on the firm s net investment in certain non-U.S. operations.

To qualify for hedge accounting, the derivative hedge must be highly effective at reducing the risk from the exposure being hedged. Additionally, the firm must formally document the hedging relationship at inception and test the hedging relationship at least on a quarterly basis to ensure the derivative hedge continues to be highly effective over the life of the hedging relationship.

Table of Contents

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Interest Rate Hedges

The firm designates certain interest rate swaps as fair value hedges. These interest rate swaps hedge changes in fair value attributable to the relevant benchmark interest rate (e.g., London Interbank Offered Rate (LIBOR)), effectively converting a substantial portion of fixed-rate obligations into floating-rate obligations.

The firm applies a statistical method that utilizes regression analysis in assessing the effectiveness of its fair value hedging relationships in achieving offsetting changes in the fair values of the hedging instrument and the risk being hedged (i.e., interest rate risk). An interest rate swap is considered highly effective in offsetting changes in fair value attributable to changes in the hedged risk when the regression analysis results in a coefficient of determination of 80% or greater and a slope between 80% and 125%.

For qualifying fair value hedges, gains or losses on derivatives are included in Interest expense. The change in fair value of the hedged item attributable to the risk being hedged is reported as an adjustment to its carrying value and is subsequently amortized into interest expense over its remaining life. Gains or losses resulting from hedge ineffectiveness are included in Interest expense. When a derivative is no longer designated as a hedge, any remaining difference between the carrying value and par value of the hedged item is amortized to interest expense over the remaining life of the hedged item using the effective interest method. See Note 23 for further information about interest income and interest expense.

The table below presents the gains/(losses) from interest rate derivatives accounted for as hedges, the related hedged borrowings and bank deposits, and the hedge ineffectiveness on these derivatives.

	Three Months Ended March	
in millions	**2012**	2011
Interest rate hedges	**$ (2,238)**	$ (2,658)
Hedged borrowings and bank deposits	**1,778**	2,163
Hedge ineffectiveness [1]	**(460)**	(495)

1. Primarily consisted of amortization of prepaid credit spreads resulting from the passage of time.

Net Investment Hedges

The firm seeks to reduce the impact of fluctuations in foreign exchange rates on its net investment in certain non-U.S. operations through the use of foreign currency forward contracts and foreign currency-denominated debt. For foreign currency forward contracts designated as hedges, the effectiveness of the hedge is assessed based on the overall changes in the fair value of the forward contracts (i.e., based on changes in forward rates). For foreign currency-denominated debt designated as a hedge, the effectiveness of the hedge is assessed based on changes in spot rates.

For qualifying net investment hedges, the gains or losses on the hedging instruments, to the extent effective, are included in Currency translation adjustment, net of tax within the condensed consolidated statements of comprehensive income.

The table below presents the gains/(losses) from net investment hedging.

in millions	Three Months Ended March **2012**	2011
Currency hedges	**$ (212)**	$ (225)
Foreign currency-denominated debt	**221**	82

The gain/(loss) related to ineffectiveness and the gain/(loss) reclassified to earnings from accumulated other comprehensive income was not material for the three months ended March 2012 and March 2011.

As of March 2012 and December 2011, the firm had designated $2.89 billion and $3.11 billion, respectively, of foreign currency-denominated debt, included in Unsecured long-term borrowings and Unsecured short-term borrowings, as hedges of net investments in non-U.S. subsidiaries.

Table of Contents

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Note 8. Fair Value Option

Note 8.

Fair Value Option

Other Financial Assets and Financial Liabilities at Fair Value

In addition to all cash and derivative instruments included in Financial instruments owned, at fair value and Financial instruments sold, but not yet purchased, at fair value, the firm has elected to account for certain of its other financial assets and financial liabilities at fair value under the fair value option.

The primary reasons for electing the fair value option are to:

- reflect economic events in earnings on a timely basis;
- mitigate volatility in earnings from using different measurement attributes (e.g., transfers of financial instruments owned accounted for as financings are recorded at fair value whereas the related secured financing would be recorded on an accrual basis absent electing the fair value option); and
- address simplification and cost-benefit considerations (e.g., accounting for hybrid financial instruments at fair value in their entirety versus bifurcation of embedded derivatives and hedge accounting for debt hosts).

Hybrid financial instruments are instruments that contain bifurcatable embedded derivatives 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 from the associated debt, the derivative 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 hedges. If the firm does not elect to bifurcate, the entire hybrid financial instrument is accounted for at fair value under the fair value option.

Other financial assets and financial liabilities accounted for at fair value under the fair value option include:

- resale and repurchase agreements;
- securities borrowed and loaned within Fixed Income, Currency and Commodities Client Execution;

- certain other secured financings, primarily transfers of assets accounted for as financings rather than sales and certain other nonrecourse financings;
- certain unsecured short-term borrowings, consisting of all promissory notes and commercial paper and certain hybrid financial instruments;
- certain unsecured long-term borrowings, including prepaid commodity transactions and certain hybrid financial instruments;
- certain receivables from customers and counterparties, including certain margin loans and transfers of assets accounted for as secured loans rather than purchases;
- certain insurance and reinsurance contract assets and liabilities and certain guarantees;
- certain subordinated liabilities issued by consolidated VIEs; and
- certain time deposits issued by the firm s bank subsidiaries (deposits with no stated maturity are not eligible for a fair value option election).

These financial assets and financial liabilities at fair value are generally valued based on discounted cash flow techniques, which incorporate inputs with reasonable levels of price transparency, and are generally classified as level 2 because the inputs are observable. Valuation adjustments may be made for liquidity and for counterparty and the firm s credit quality.

See below for information about the significant inputs used to value other financial assets and financial liabilities at fair value, including the ranges of significant unobservable inputs used to value the level 3 instruments within these categories. These ranges represent the significant unobservable inputs that were used in the valuation of each type of other financial assets and financial liabilities at fair value. These inputs are not representative of the inputs that could have been used in the valuation of any one instrument. For example, the highest funding spread presented below for resale and repurchase agreements is appropriate for valuing a specific agreement in that category but may not be appropriate for valuing any other agreements in that category. Accordingly, the range of inputs presented below do not represent uncertainty in, or possible ranges of, fair value measurements of the firm s level 3 other financial assets and financial liabilities.

Table of Contents

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Resale and Repurchase Agreements and Securities Borrowed and Loaned. The significant inputs to the valuation of resale and repurchase agreements and securities borrowed and loaned are the amount and timing of expected future cash flows, interest rates, the fair value of the collateral delivered or received by the firm (which is determined using the amount and timing of expected future cash flows, market yields and recovery assumptions), and collateral funding spreads. The ranges of significant unobservable inputs used to value level 3 resale and repurchase agreements as of March 2012 are as follows:

Yield: 2.1% to 4.5%

Duration: 2.0 to 5.4 years

Funding spreads: 74 bps to 355 bps

Generally, increases in yield, duration or funding spreads, in isolation, would result in a lower fair value measurement. Due to the distinctive nature of each of the firm s level 3 resale and repurchase agreements, the interrelationship of inputs is not necessarily uniform across such agreements.

See Note 9 for further information about collateralized agreements.

Other Secured Financings. The significant inputs to the valuation of other secured financings at fair value are the amount and timing of expected future cash flows, interest rates, the fair value of the collateral delivered by the firm (which is determined using the amount and timing of expected future cash flows, market yields and recovery assumptions), the frequency of additional collateral calls and the credit spreads of the firm. The ranges of significant unobservable inputs used to value level 3 other secured financings as of March 2012 are as follows:

Yield: 3.5% to 25.0%

Duration: 0.7 to 7.0 years

Generally, increases in yield or duration, in isolation, would result in a lower fair value measurement. Due to the distinctive nature of each of the firm s level 3 other secured financings, the interrelationship of inputs is not necessarily uniform across such financings.

See Note 9 for further information about collateralized financings.

Unsecured Short-term and Long-term Borrowings. The significant inputs to the valuation of unsecured short-term and long-term borrowings at fair value are the amount and timing of expected future cash flows, interest rates, the credit spreads of the firm, as well as commodity prices in the case of prepaid commodity transactions and, for certain hybrid financial instruments, equity prices, inflation rates and index levels. See Notes 15 and 16 for further information about unsecured short-term and long-term borrowings, respectively.

Certain of the firm s unsecured short-term and long-term instruments are included in level 3, substantially all of which are hybrid financial instruments. As the significant unobservable inputs used to value hybrid financial instruments primarily relate to the embedded derivative component of these borrowings, these inputs are incorporated in the firm s derivative disclosures related to unobservable inputs in Note 7.

Insurance and Reinsurance Contracts. Insurance and reinsurance contracts at fair value are included in Receivables from customers and counterparties and Other liabilities and accrued expenses. The insurance and reinsurance contracts for which the firm has elected the fair value option are contracts that can be settled only in cash and that qualify for the fair value option because they are recognized financial instruments. These contracts are valued using market transactions and other market evidence where possible, including market-based inputs to models, calibration to market-clearing transactions or other alternative pricing sources with reasonable levels of price transparency. Significant level 2 inputs typically include interest rates, inflation rates, volatilities, and policy lapse and projected mortality assumptions. Significant level 3 inputs typically include funding spreads. When unobservable inputs to a valuation model are significant to the fair value measurement of an instrument, the instrument is classified in level 3. The range of significant unobservable inputs used to value level 3 insurance and reinsurance contracts as of March 2012 is as follows:

- Funding spreads: 80 bps to 170 bps

Generally, increases in funding spreads would result in a lower fair value measurement of both assets and liabilities.

Table of Contents

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Receivables from Customers and Counterparties. Receivables from customers and counterparties at fair value, excluding insurance and reinsurance contracts, are primarily comprised of transfers of assets accounted for as secured loans rather than purchases. The significant inputs to the valuation of such receivables are commodity prices, interest rates and the amount and timing of expected future cash flows. Receivables from customers and counterparties not accounted for at fair value are accounted for at amortized cost net of estimated uncollectible amounts, which generally approximates fair value. Such receivables are primarily comprised of customer margin loans. While these margin loans are carried at amounts that approximate fair value, they are not accounted for at fair value under the fair value option or at fair value in accordance with other

U.S. GAAP and therefore are not included in the firm s fair value hierarchy in Notes 6, 7 and 8. Had these margin loans been included in the firm s fair value hierarchy, substantially all would have been classified in level 2 as of March 2012.

Deposits. The significant inputs to the valuation of time deposits are interest rates and the amount and timing of future cash flows. See Note 14 for further information about deposits.

Fair Value of Other Financial Assets and Financial Liabilities by Level

The tables below present, by level within the fair value hierarchy, other financial assets and financial liabilities accounted for at fair value under the fair value option.

	Other Financial Assets at Fair Value as of March 2012			
in millions	**Level 1**	**Level 2**	**Level 3**	**Total**
Securities segregated for regulatory and other purposes [1]	**$24,231**	**$ 9,448**	**$**	**$ 33,679**
Securities purchased under agreements to resell		**180,094**	**956**	**181,050**
Securities borrowed		**57,062**		**57,062**
Receivables from customers and counterparties		**7,897**	**431**	**8,328**
Total	**$24,231**	**$254,501**	**$ 1,387**	**$280,119**

	Other Financial Liabilities at Fair Value as of March 2012			
in millions	**Level 1**	**Level 2**	**Level 3**	**Total**
Deposits	**$**	**$ 5,428**	**$ 96**	**$ 5,524**
Securities sold under agreements to repurchase		**171,044**	**2,048**	**173,092**
Securities loaned		**550**		**550**
Other secured financings		**27,085**	**1,282**	**28,367**
Unsecured short-term borrowings		**14,397**	**3,375**	**17,772**
Unsecured long-term borrowings		**15,199**	**2,310**	**17,509**
Other liabilities and accrued expenses		**486**	**8,965**	**9,451**
Total	**$**	**$234,189**	**$18,076**	**$252,265**

1. Includes securities segregated for regulatory and other purposes accounted for at fair value under the fair value option, which consists of securities borrowed and resale agreements. The table above includes $24.23 billion of level 1 and $534 million of level 2 securities segregated for regulatory and other purposes accounted for at fair value under other U.S. GAAP, principally consisting of U.S. Treasury securities, money market instruments and insurance separate account assets.

Table of Contents

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

	Other Financial Assets at Fair Value as of December 2011			
in millions	Level 1	Level 2	Level 3	Total
Securities segregated for regulatory and other purposes [1]	$21,263	$ 20,751	$	$ 42,014
Securities purchased under agreements to resell		187,232	557	187,789
Securities borrowed		47,621		47,621
Receivables from customers and counterparties		8,887	795	9,682
Total	$21,263	$264,491	$ 1,352	$287,106

	Other Financial Liabilities at Fair Value as of December 2011			
in millions	Level 1	Level 2	Level 3	Total
Deposits	$	$ 4,513	$ 13	$ 4,526
Securities sold under agreements to repurchase		162,321	2,181	164,502
Securities loaned		107		107
Other secured financings		28,267	1,752	30,019
Unsecured short-term borrowings		14,560	3,294	17,854
Unsecured long-term borrowings		14,971	2,191	17,162
Other liabilities and accrued expenses		490	8,996	9,486
Total	$	$225,229	$18,427	$243,656

1. Includes securities segregated for regulatory and other purposes accounted for at fair value under the fair value option, which consists of securities borrowed and resale agreements. The table above includes $21.26 billion of level 1 and $528 million of level 2 securities segregated for regulatory and other purposes accounted for at fair value under other U.S. GAAP, principally consisting of U.S. Treasury securities, money market instruments and insurance separate account assets.

Table of Contents

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Level 3 Rollforward

If a financial asset or financial liability was transferred to level 3 during a reporting period, its entire gain or loss for the period is included in level 3. Transfers between levels are recognized at the beginning of the reporting period in which they occur.

The tables below present changes in fair value for other financial assets and financial liabilities accounted for at fair value under the fair value option categorized as level 3 as of

the end of the period. Level 3 other financial assets and liabilities are frequently economically hedged with cash instruments and derivatives. Accordingly, gains or losses that are reported in level 3 can be partially offset by gains or losses attributable to level 1, 2 or 3 cash instruments or derivatives. As a result, gains or losses included in the level 3 rollforward below do not necessarily represent the overall impact on the firm s results of operations, liquidity or capital resources.

Level 3 Other Financial Assets at Fair Value for the Three Months Ended March 2012

in millions	Balance, beginning of period	Net realized gains/ (losses)	Net unrealized gains/(losses) relating to instruments still held at period-end	Purchases	Sales	Issues	Settlements	Transfers into level 3	Transfers out of level 3	Balance, end of period
Securities purchased under agreements to resell	$ 557	$ 1	$ 30	$535	$	$	$(167)	$	$	$ 956
Receivables from customers and counterparties	795		9						(373)	431
Total	$ 1,352	$ 1 [1]	$ 39 [1]	$535	$	$	$(167)	$	$(373)	$ 1,387

1. The aggregate amounts include gains of approximately $37 million and $3 million reported in Market making and Interest income, respectively.

Level 3 Other Financial Liabilities at Fair Value for the Three Months Ended March 2012

in millions	Balance, beginning of period	Net realized (gains)/ losses	Net unrealized (gains)/losses relating to instruments still held at period-end	Purchases	Sales	Issues	Settlements	Transfers into level 3	Transfers out of level 3	Balance, end of period
Deposits	$ 13	$	$ (6)	$	$	$ 89	$	$	$	$ 96
Securities sold under agreements to repurchase, at fair value	2,181						(133)			2,048
Other secured financings	1,752	1	(1)			24	(465)	14	(43)	1,282
Unsecured short-term borrowings	3,294	(16)	152	(13)		129	(118)	167	(220)	3,375
Unsecured long-term borrowings	2,191	11	176			155	(116)	134	(241)	2,310
Other liabilities and accrued expenses	8,996	4	50				(85)			8,965

Total	**$18,427**	**$ [1]**	**$371 [1]**	**$ (13)**	**$**	**$397**	**$(917)**	**$315**	**$(504)**	**$18,076**

1. The aggregate amounts include losses of approximately $355 million, $15 million and $1 million reported in "Market making," "Other principal transactions" and "Interest expense," respectively.

The net unrealized gain/(loss) on level 3 other financial assets and liabilities at fair value of $(332) million (reflecting $39 million on other financial assets and $(371) million on other financial liabilities) for the three months ended March 2012 primarily consisted of losses on unsecured short-term and long-term borrowings. These losses primarily reflected losses on certain equity-linked notes, principally due to an increase in global equity prices which are level 2 inputs.

Transfers out of level 3 related to other financial assets during the three months ended March 2012 reflected transfers to level 2 of certain insurance receivables primarily due to increased transparency of the mortality inputs used to value these receivables.

Transfers into level 3 related to other financial liabilities during the three months ended March 2012 primarily reflected transfers from level 2 of certain unsecured short-term and long-term borrowings, principally due to reduced transparency of the correlation and volatility inputs used to value certain hybrid financial instruments.

Transfers out of level 3 related to other financial liabilities during the three months ended March 2012 primarily reflected transfers to level 2 of certain unsecured short-term and long-term borrowings, principally due to increased transparency of the correlation and volatility inputs used to value certain hybrid financial instruments.

Table of Contents

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

	Level 3 Other Financial Assets at Fair Value for the Three Months Ended March 2011								
in millions	Balance, beginning of period	Net realized gains/ (losses)	Net unrealized gains/(losses) relating to instruments still held at period-end	Purchases	Sales	Issues	Settlements	Net transfers in and/or (out) of level 3	Balance, end of period
Securities purchased under agreements to resell	$ 100	$ 2	$	$ 64	$	$	$ (8)	$	$ 158
Receivables from customers and counterparties	298		16	14			(6)		322
Total	$ 398	$ 2 [1]	$ 16 [1]	$ 78	$	$	$ (14)	$	$ 480

1. The aggregate amounts include gains of approximately $16 million and $2 million reported in Market making and Other principal transactions , respectively.

	Level 3 Other Financial Liabilities at Fair Value for the Three Months Ended March 2011								
in millions	Balance, beginning of period	Net realized (gains)/ losses	Net unrealized (gains)/losses relating to instruments still held at period-end	Purchases	Sales	Issues	Settlements	Net transfers in and/or (out) of level 3	Balance, end of period
Securities sold under agreements to repurchase, at fair value	$ 2,060	$	$	$	$	$	$ (114)	$	$ 1,946
Other secured financings	8,349		9			11	(1,262)		7,107
Unsecured short-term borrowings	3,476	60	(204)			562	(153)	(532)	3,209
Unsecured long-term borrowings	2,104	4	45			241	(72)	82	2,404
Other liabilities and accrued expenses	2,409		152	4,337			(46)		6,852
Total	$18,398	$64 [1]	$ 2 [1]	$4,337	$	$814	$(1,647)	$(450)	$21,518

1. The aggregate amounts include gains/(losses) of approximately $(165) million, $104 million and $(5) million reported in Market making, Other principal transactions and Interest expense, respectively.

Significant transfers in or out of level 3 during the three months ended March 2011 included:

Unsecured short-term borrowings and Unsecured long-term borrowings: net transfer out of level 3 of $532 million and net transfer into level 3 of $82 million, respectively, principally due to a transfer of
approximately $230 million from level 3 Unsecured short-term borrowings to level 3 Unsecured long-term borrowings related to an extension in the tenor of certain borrowings and the transfer to level 2 of certain short-term and long-term hybrid financial instruments due to improved transparency of the equity price inputs used to value these financial instruments.

Table of Contents

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Gains and Losses on Other Financial Assets and

Financial Liabilities at Fair Value

The Fair Value Option columns in the table below present the gains and losses recognized as a result of the firm electing to apply the fair value option to certain financial assets and financial liabilities. These gains and losses are included in Market making and Other principal transactions.

The amounts in the table exclude contractual interest, which is included in Interest income and Interest expense, for all instruments other than hybrid financial instruments. See Note 23 for further information about interest income and interest expense. The table also excludes gains and losses related to financial instruments owned, at fair value and financial instruments sold, but not yet purchased, at fair value.

Included in the Other columns in the table below are:

Gains and losses on the embedded derivative component of hybrid financial instruments included in unsecured short-term borrowings and unsecured long-term borrowings. These gains and losses would have been recognized under other U.S. GAAP even if the firm had not elected to account for the entire hybrid instrument at fair value.

Gains and losses on secured financings related to transfers of assets accounted for as financings rather than sales. These gains and losses are offset by gains and losses on the related instruments included in Financial instruments owned, at fair value and Receivables from customers and counterparties.

Gains and losses on receivables from customers and counterparties related to transfers of assets accounted for as receivables rather than purchases. These gains and losses are offset by gains and losses on the related financial instruments included in Other secured financings.

Gains and losses on subordinated liabilities issued by consolidated VIEs, which are included in Other liabilities and accrued expenses. These gains and losses are offset by gains and losses on the financial assets held by the consolidated VIEs.

	Gains/(Losses) on Other Financial Assets and Financial Liabilities at Fair Value Three Months Ended March			
	2012		2011	
in millions	**Fair Value Option**	**Other**	Fair Value Option	Other
Receivables from customers and counterparties [1]	**$ 24**	**$ 459**	$ 1	$ 319
Other secured financings	**(26)**	**(915)**	4	(415)
Unsecured short-term borrowings	**(42)**	**(853)**	7	(224)

Unsecured long-term borrowings	**(231)**	**(368)**	3	(1,271)
Other liabilities and accrued expenses [2]	**(102)**	**41**	(189)	87
Other [3]	**(17)**	**5**	35	
Total	**$ (394)**	**$ (1,631)**	$ (139)	$ (1,504)

1. Primarily consists of gains on certain transfers accounted for as receivables rather than purchases and certain reinsurance contracts.

2. Primarily consists of gains/(losses) on certain insurance contracts.

3. Primarily consists of gains/(losses) on resale and repurchase agreements, securities borrowed and loaned and deposits.

Excluding the gains and losses on the instruments accounted for under the fair value option described above, Market making and Other principal transactions

primarily represents gains and losses on Financial instruments owned, at fair value and Financial instruments sold, but not yet purchased, at fair value.

43

Table of Contents

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Loans and Lending Commitments

The table below presents the difference between the aggregate fair value and the aggregate contractual principal amount for loans and long-term receivables for which the fair value option was elected.

	As of March	December
in millions	**2012**	2011
Aggregate contractual principal amount of performing loans and long-term receivables in excess of the related fair value	**$ 3,347**	$ 3,826
Aggregate contractual principal amount of loans on nonaccrual status and/or more than 90 days past due in excess of the related fair value	**22,228**	23,034
Total [1]	**$25,575**	$26,860
Aggregate fair value of loans on nonaccrual status and/or more than 90 days past due	**$ 2,378**	$ 3,174

1. The aggregate contractual principal exceeds the related fair value primarily because the firm regularly purchases loans, such as distressed loans, at values significantly below contractual principal amounts.

As of March 2012 and December 2011, the fair value of unfunded lending commitments for which the fair value option was elected was a liability of $2.18 billion and $2.82 billion, respectively, and the related total contractual amount of these lending commitments was $62.61 billion and $66.12 billion, respectively. See Note 18 for further information about lending commitments.

Long-term Debt Instruments

The aggregate contractual principal amount of long-term debt instruments (principal and non-principal protected) for which the fair value option was elected exceeded the related fair value by $393 million and $932 million as of March 2012 and December 2011, respectively. Of these amounts, $196 million and $693 million as of March 2012 and December 2011, respectively, related to unsecured long-term borrowings and the remainder related to long-term other secured financings.

Impact of Credit Spreads on Loans and Lending Commitments

The estimated net gain attributable to changes in instrument-specific credit spreads on loans and lending commitments for which the fair value option was elected was $973 million and $756 million for the three months ended March 2012 and March 2011, respectively. Changes in the fair value of loans and lending commitments are primarily attributable to changes in instrument-specific credit spreads. Substantially all of the firm s performing loans and lending commitments are floating-rate.

Impact of Credit Spreads on Borrowings

The table below presents the net gains/(losses) attributable to the impact of changes in the firm s own credit spreads on borrowings for which the fair value option was elected. The firm calculates the fair value of borrowings by discounting future cash flows at a rate which incorporates the firm s credit spreads.

in millions	Three Months Ended March **2012**	2011
Net gains/(losses) including hedges	**$(224)**	$41
Net gains/(losses) excluding hedges	**(289)**	44

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Note 9. Collateralized Agreements and Financings

Note 9.

Collateralized Agreements and Financings

Collateralized agreements are securities purchased under agreements to resell (resale agreements or reverse repurchase agreements) and securities borrowed. Collateralized financings are securities sold under agreements to repurchase (repurchase agreements), securities loaned and other secured financings. The firm enters into these transactions in order to, among other things, facilitate client activities, invest excess cash, acquire securities to cover short positions and finance certain firm activities.

Collateralized agreements and financings are presented on a net-by-counterparty basis when a legal right of setoff exists. Interest on collateralized agreements and collateralized financings is recognized over the life of the transaction and included in Interest income and Interest expense, respectively. See Note 23 for further information about interest income and interest expense.

The table below presents the carrying value of resale and repurchase agreements and securities borrowed and loaned transactions.

	As of	
in millions	**March 2012**	December 2011
Securities purchased under agreements to resell [1]	**$181,050**	$187,789
Securities borrowed [2]	**169,092**	153,341
Securities sold under agreements to repurchase [1]	**173,092**	164,502
Securities loaned [2]	**8,121**	7,182

1. Resale and repurchase agreements are carried at fair value under the fair value option. See Note 8 for further information about the valuation techniques and significant inputs used to determine fair value.

2. As of March 2012 and December 2011, $57.06 billion and $47.62 billion of securities borrowed and $550 million and $107 million of securities loaned were at fair value, respectively.

Resale and Repurchase Agreements

A resale agreement is a transaction in which the firm purchases financial instruments from a seller, typically in exchange for cash, and simultaneously enters into an agreement to resell the same or substantially the same financial instruments to the seller at a stated price plus accrued interest at a future date.

A repurchase agreement is a transaction in which the firm sells financial instruments to a buyer, typically in exchange for cash, and simultaneously enters into an agreement to repurchase the same or substantially the same financial instruments from the buyer at a stated price plus accrued interest at a future date.

The financial instruments purchased or sold in resale and repurchase agreements typically include U.S. government and federal agency, and investment-grade sovereign obligations.

The firm receives financial instruments purchased under resale agreements, makes delivery of financial instruments sold under repurchase agreements, monitors the market value of these financial instruments on a daily basis, and delivers or obtains additional collateral due to changes in the market value of the financial instruments, as appropriate. For resale agreements, the firm typically requires delivery of collateral with a fair value approximately equal to the carrying value of the relevant assets in the condensed consolidated statements of financial condition.

Even though repurchase and resale agreements involve the legal transfer of ownership of financial instruments, they are accounted for as financing arrangements because they require the financial instruments to be repurchased or resold at the maturity of the agreement. However, repos to maturity are accounted for as sales. A repo to maturity is a transaction in which the firm transfers a security under an agreement to repurchase the security where the maturity date of the repurchase agreement matches the maturity date of the underlying security. Therefore, the firm effectively no longer has a repurchase obligation and has relinquished control over the underlying security and, accordingly, accounts for the transaction as a sale. The firm had no repos to maturity outstanding as of March 2012 or December 2011.

Table of Contents

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Securities Borrowed and Loaned Transactions

In a securities borrowed transaction, the firm borrows securities from a counterparty in exchange for cash. When the firm returns the securities, the counterparty returns the cash. Interest is generally paid periodically over the life of the transaction.

In a securities loaned transaction, the firm lends securities to a counterparty typically in exchange for cash or securities, or a letter of credit. When the counterparty returns the securities, the firm returns the cash or securities posted as collateral. Interest is generally paid periodically over the life of the transaction.

The firm receives securities borrowed, makes delivery of securities loaned, monitors the market value of these securities on a daily basis, and delivers or obtains additional collateral due to changes in the market value of the securities, as appropriate. For securities borrowed transactions, the firm typically requires delivery of collateral with a fair value approximately equal to the carrying value of the securities borrowed transaction.

Securities borrowed and loaned within Fixed Income, Currency and Commodities Client Execution are recorded at fair value under the fair value option.

Securities borrowed and loaned within Securities Services 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. Therefore, the carrying value of such arrangements approximates fair value. While these arrangements are carried at amounts that approximate fair value, they are not accounted for at fair value under the fair value option or at fair value in accordance with other U.S. GAAP and therefore are not included in the firm s fair value hierarchy in Notes 6, 7 and 8. Had these arrangements been included in the firm s fair value hierarchy, they would have been classified in level 2 as of March 2012.

As of March 2012 and December 2011, the firm had $8.91 billion and $20.22 billion, respectively, of securities received under resale agreements and securities borrowed transactions that were segregated to satisfy certain regulatory requirements. These securities are included in Cash and securities segregated for regulatory and other purposes.

Other Secured Financings

In addition to repurchase agreements and securities lending transactions, the firm funds certain assets through the use of other secured financings and pledges financial instruments and other assets as collateral in these transactions. These other secured financings consist of:

- liabilities of consolidated VIEs;
- transfers of assets accounted for as financings rather than sales (primarily collateralized central bank financings, pledged commodities, bank loans and mortgage whole loans); and
- other structured financing arrangements.

Other secured financings include arrangements that are nonrecourse. As of March 2012 and December 2011, nonrecourse other secured financings were $2.31 billion and $3.14 billion, respectively.

The firm has elected to apply the fair value option to the following other secured financings because the use of fair value eliminates non-economic volatility in earnings that would arise from using different measurement attributes:

- transfers of assets accounted for as financings rather than sales; and
- certain other nonrecourse financings.

See Note 8 for further information about other secured financings that are accounted for at fair value. Other secured financings that are not recorded at fair value are generally short-term and recorded based on the amount of cash received plus accrued interest, which generally approximates fair value. While these financings are carried at amounts that approximate fair value, they are not accounted for at fair value under the fair value option or at fair value in accordance with other U.S. GAAP and therefore are not included in the firm s fair value hierarchy in Notes 6, 7 and 8. Had these financings been included in the firm s fair value hierarchy, they would have primarily been classified in level 2 as of March 2012.

Table of Contents

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

The table below presents information about other secured financings. In the table below:

short-term secured financings include financings maturing within one year of the financial statement date and financings that are redeemable within one year of the financial statement date at the option of the holder;

long-term secured financings that are repayable prior to maturity at the option of the firm are reflected at their contractual maturity dates; and

long-term secured financings that are redeemable prior to maturity at the option of the holders are reflected at the dates such options become exercisable.

	As of March 2012			As of December 2011		
$ in millions	U.S. Dollar	Non-U.S. Dollar	Total	U.S. Dollar	Non-U.S. Dollar	Total
Other secured financings (short-term):						
At fair value	**$ 16,980**	**$ 5,213**	**$ 22,193**	$ 18,519	$ 5,140	$ 23,659
At amortized cost	**144**	**2,991**	**3,135**	155	5,371	5,526
Interest rates [1]	***3.20%***	***0.19%***		*3.85%*	*0.22%*	
Other secured financings (long-term):						
At fair value	**4,725**	**1,449**	**6,174**	4,305	2,055	6,360
At amortized cost	**891**	**746**	**1,637**	1,024	795	1,819
Interest rates [1]	***2.53%***	***3.25%***		*1.88%*	*3.28%*	
Total [2]	**$ 22,740**	**$10,399**	**$ 33,139**	$ 24,003	$13,361	$ 37,364
Amount of other secured financings collateralized by:						
Financial instruments [3]	**$ 22,437**	**$ 9,820**	**$ 32,257**	$ 23,703	$12,169	$ 35,872
Other assets [4]	**303**	**579**	**882**	300	1,192	1,492

1. The weighted average interest rates exclude secured financings at fair value and include the effect of hedging activities. See Note 7 for further information about hedging activities.

2. Includes $7.45 billion and $9.36 billion related to transfers of financial assets accounted for as financings rather than sales as of March 2012 and December 2011, respectively. Such financings were collateralized by financial assets included in Financial instruments owned, at fair value of $7.66 billion and $9.51 billion as of March 2012 and December 2011, respectively.

3. Includes $16.47 billion and $14.82 billion of other secured financings collateralized by financial instruments owned, at fair value as of March 2012 and December 2011, respectively, and includes $15.79 billion and $21.06 billion of other secured financings collateralized by financial instruments received as collateral and repledged as of March 2012 and December 2011, respectively.

4. Primarily real estate and cash.

The table below presents other secured financings by maturity.

	As of
in millions	**March 2012**
Other secured financings (short-term)	**$25,328**
Other secured financings (long-term):	
2013	**1,437**
2014	**3,635**
2015	**576**
2016	**438**
2017	**201**
2018-thereafter	**1,524**
Total other secured financings (long-term)	**7,811**
Total other secured financings	**$33,139**

The aggregate contractual principal amount of other secured financings (long-term) for which the fair value option was elected exceeded the related fair value by $197 million and $239 million, as of March 2012 and December 2011, respectively.

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Collateral Received and Pledged

The firm receives financial instruments (e.g., U.S. government and federal agency, other sovereign and corporate obligations, as well as equities and convertible debentures) as collateral, primarily in connection with resale agreements, securities borrowed, derivative transactions and customer margin loans.

In many cases, the firm is permitted to deliver or repledge these financial instruments when entering into repurchase agreements and securities lending agreements, primarily in connection with secured client financing activities. The firm is also permitted to deliver or repledge these financial instruments in connection with other secured financings, collateralizing derivative transactions and meeting firm or customer settlement requirements.

The table below presents financial instruments at fair value received as collateral that were available to be delivered or repledged and were delivered or repledged by the firm.

	As of	
in millions	**March 2012**	December 2011
Collateral available to be delivered or repledged	**$606,896**	$622,926
Collateral that was delivered or repledged	**447,378**	454,604

The firm also pledges certain financial instruments owned, at fair value in connection with repurchase agreements, securities lending agreements and other secured financings, and other assets (primarily real estate and cash) in connection with other secured financings to counterparties who may or may not have the right to deliver or repledge them. The table below presents information about assets pledged by the firm.

	As of	
in millions	**March 2012**	December 2011
Financial instruments owned, at fair value pledged to counterparties that:		
Had the right to deliver or repledge	**$ 67,404**	$ 53,989
Did not have the right to deliver or repledge	**122,681**	110,949
Other assets pledged to counterparties that:		
Did not have the right to deliver or repledge	**2,921**	3,444

Note 10. Securitization Activities

Note 10.

Securitization Activities

The firm securitizes residential and commercial mortgages, corporate bonds, loans and other types of financial assets by selling these assets to securitization vehicles (e.g., trusts, corporate entities and limited liability companies) and acts as underwriter of the beneficial interests that are sold to investors. The firm s residential mortgage securitizations are substantially all in connection with government agency securitizations.

Beneficial interests issued by securitization entities are debt or equity securities that give the investors rights to receive all or portions of specified cash inflows to a securitization vehicle and include senior and subordinated shares of principal, interest and/or other cash inflows. The proceeds from the sale of beneficial interests are used to pay the transferor for the financial assets sold to the securitization vehicle or to purchase securities which serve as collateral.

The firm accounts for a securitization as a sale when it has relinquished control over the transferred assets. Prior to securitization, the firm accounts for assets pending transfer at fair value and therefore does not typically recognize significant gains or losses upon the transfer of assets. Net revenues from underwriting activities are recognized in connection with the sales of the underlying beneficial interests to investors.

For transfers of assets that are not accounted for as sales, the assets remain in Financial instruments owned, at fair value and the transfer is accounted for as a collateralized financing, with the related interest expense recognized over the life of the transaction. See Notes 9 and 23 for further information about collateralized financings and interest expense, respectively.

The firm generally receives cash in exchange for the transferred assets but may also have continuing involvement with transferred assets, including ownership of beneficial interests in securitized financial assets, primarily in the form of senior or subordinated securities. The firm may also purchase senior or subordinated securities issued by securitization vehicles (which are typically VIEs) in connection with secondary market-making activities.

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

The primary risks included in beneficial interests and other interests from the firm s continuing involvement with securitization vehicles are the performance of the underlying collateral, the position of the firm s investment in the capital structure of the securitization vehicle and the market yield for the security. These interests are accounted for at fair value and are included in Financial instruments owned, at fair value and are generally classified in level 2 of the fair value hierarchy. See Notes 5 through 8 for further information about fair value measurements.

The table below presents the amount of financial assets securitized and the cash flows received on retained interests in securitization entities in which the firm had continuing involvement.

	Three Months Ended March	
in millions	**2012**	2011
Residential mortgages	**$ 10,989**	$7,703
Commercial mortgages		325
Other financial assets		32
Total	**$ 10,989**	$8,060
Cash flows on retained interests	**$ 147**	$ 228

The table below presents the firm s continuing involvement in nonconsolidated securitization entities to which the firm sold assets, as well as the total outstanding principal amount of transferred assets in which the firm has continuing involvement. In this table:

- the outstanding principal amount is presented for the purpose of providing information about the size of the securitization entities in which the firm has continuing involvement and is not representative of the firm s risk of loss;
- for retained or purchased interests, the firm s risk of loss is limited to the fair value of these interests; and
- purchased interests represent senior and subordinated interests, purchased in connection with secondary market-making activities, in securitization entities in which the firm also holds retained interests.

	As of March 2012			As of December 2011		
in millions	**Outstanding Principal Amount**	**Fair Value of Retained Interests**	**Fair Value of Purchased Interests**	Outstanding Principal Amount	Fair Value of Retained Interests	Fair Value of Purchased Interests
U.S. government agency-issued collateralized mortgage obligations [1]	**$67,883**	**$4,913**	**$**	$70,448	$5,038	$
Other residential mortgage-backed [2]	**4,274**	**101**		4,459	101	3
Commercial mortgage-backed [3]	**2,311**	**28**	**46**	3,398	606	331
CDOs, CLOs and other [4]	**10,305**	**44**	**263**	9,972	32	211
Total [5]	**$84,773**	**$5,086**	**$309**	$88,277	$5,777	$545

1. Outstanding principal amount and fair value of retained interests primarily relate to securitizations during 2012 and 2011 as of March 2012, and securitizations during 2011 and 2010 as of December 2011.

2. Outstanding principal amount and fair value of retained interests as of both March 2012 and December 2011 primarily relate to prime and Alt-A securitizations during 2007 and 2006.

3. As of March 2012, the outstanding principal amount and the fair value of retained interests primarily relate to securitizations during 2006. As of December 2011, the outstanding principal amount primarily relates to securitizations during 2010, 2007 and 2006 and the fair value of retained interests primarily relates to securitizations during 2010.

4. Outstanding principal amount and fair value of retained interests as of both March 2012 and December 2011 primarily relate to CDO and CLO securitizations during 2007 and 2006.

5. Outstanding principal amount includes $789 million and $774 million as of March 2012 and December 2011, respectively, related to securitization entities in which the firm s only continuing involvement is retained servicing which is not a variable interest.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

In addition to the interests in the table above, the firm had other continuing involvement in the form of derivative transactions and guarantees with certain nonconsolidated VIEs. The carrying value of these derivatives and guarantees was a net asset of $2 million and a net liability of $52 million as of March 2012 and December 2011, respectively. The notional amounts of these derivatives and guarantees are included in maximum exposure to loss in the nonconsolidated VIE tables in Note 11.

The table below presents the weighted average key economic assumptions used in measuring the fair value of retained interests and the sensitivity of this fair value to immediate adverse changes of 10% and 20% in those assumptions.

	As of March 2012		As of December 2011	
	Type of Retained Interests		Type of Retained Interests	
$ in millions	**Mortgage-Backed**	**Other [1]**	Mortgage-Backed	Other [1]
Fair value of retained interests	**$5,042**	**$ 44**	$5,745	$ 32
Weighted average life (years)	**8.0**	**4.6**	7.1	4.7
Constant prepayment rate [2]	**11.9%**	**N.M.**	14.1%	N.M.
Impact of 10% adverse change [2]	**$ (46)**	**N.M.**	$ (55)	N.M.
Impact of 20% adverse change [2]	**(89)**	**N.M.**	(108)	N.M.
Discount rate [3]	**5.7%**	**N.M.**	5.4%	N.M.
Impact of 10% adverse change	**$ (118)**	**N.M.**	$ (125)	N.M.
Impact of 20% adverse change	**(230)**	**N.M.**	(240)	N.M.

1. Due to the nature and current fair value of certain of these retained interests, the weighted average assumptions for constant prepayment and discount rates and the related sensitivity to adverse changes are not meaningful as of March 2012 and December 2011. The firm s maximum exposure to adverse changes in the value of these interests is the carrying value of $44 million and $32 million as of March 2012 and December 2011, respectively.

2. Constant prepayment rate is included only for positions for which constant prepayment rate is a key assumption in the determination of fair value.

3. The majority of mortgage-backed retained interests are U.S. government agency-issued collateralized mortgage obligations, for which there is no anticipated credit loss. For the remainder of retained interests, the expected credit loss assumptions are reflected in the discount rate.

The preceding table does not give effect to the offsetting benefit of other financial instruments that are held to mitigate risks inherent in these retained interests. Changes in fair value based on an adverse variation in assumptions generally cannot be extrapolated because the relationship of the change in assumptions to the change in fair value is

not usually linear. In addition, the impact of a change in a particular assumption in the preceding table is calculated independently of changes in any other assumption. In practice, simultaneous changes in assumptions might magnify or counteract the sensitivities disclosed above.

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Note 11. Variable Interest Entities

Note 11.

Variable Interest Entities

VIEs generally finance the purchase of assets by issuing debt and equity securities that are either collateralized by or indexed to the assets held by the VIE. The debt and equity securities issued by a VIE may include tranches of varying levels of subordination. The firm s involvement with VIEs includes securitization of financial assets, as described in Note 10, and investments in and loans to other types of VIEs, as described below. See Note 10 for additional information about securitization activities, including the definition of beneficial interests. See Note 3 for the firm s consolidation policies, including the definition of a VIE.

The firm is principally involved with VIEs through the following business activities:

Mortgage-Backed VIEs and Corporate CDO and CLO VIEs. The firm sells residential and commercial mortgage loans and securities to mortgage-backed VIEs and corporate bonds and loans to corporate CDO and CLO VIEs and may retain beneficial interests in the assets sold to these VIEs. The firm purchases and sells beneficial interests issued by mortgage-backed and corporate CDO and CLO VIEs in connection with market-making activities. In addition, the firm may enter into derivatives with certain of these VIEs, primarily interest rate swaps, which are typically not variable interests. The firm generally enters into derivatives with other counterparties to mitigate its risk from derivatives with these VIEs.

Certain mortgage-backed and corporate CDO and CLO VIEs, usually referred to as synthetic CDOs or credit-linked note VIEs, synthetically create the exposure for the beneficial interests they issue by entering into credit derivatives, rather than purchasing the underlying assets. These credit derivatives may reference a single asset, an index, or a portfolio/basket of assets or indices. See Note 7 for further information about credit derivatives. These VIEs use the funds from the sale of beneficial interests and the premiums received from credit derivative counterparties to purchase securities which serve to collateralize the beneficial interest holders and/or the credit derivative counterparty. These VIEs may enter into other derivatives, primarily interest rate swaps, which are typically not variable interests. The firm may be a counterparty to derivatives with these VIEs and generally enters into derivatives with other counterparties to mitigate its risk.

Real Estate, Credit-Related and Other Investing VIEs. The firm purchases equity and debt securities issued by and makes loans to VIEs that hold real estate, performing and nonperforming debt, distressed loans and equity securities.

Other Asset-Backed VIEs. The firm structures VIEs that issue notes to clients and purchases and sells beneficial interests issued by other asset-backed VIEs in connection with market-making activities. In addition, the firm may enter into derivatives with certain other asset-backed VIEs, primarily total return swaps on the collateral assets held by these VIEs under which the firm pays the VIE the return due to the note holders and receives the return on the collateral assets owned by the VIE. The firm generally can be removed as the total return swap counterparty. The firm generally enters into derivatives with other counterparties to mitigate its risk from derivatives with these VIEs. The firm typically does not sell assets to the other asset-backed VIEs it structures.

Power-Related VIEs. The firm purchases debt and equity securities issued by and may provide guarantees to VIEs that hold power-related assets. The firm typically does not sell assets to or enter into derivatives with these VIEs.

Investment Funds. The firm purchases equity securities issued by and may provide guarantees to certain of the investment funds it manages. The firm typically does not sell assets to or enter into derivatives with these VIEs.

Principal-Protected Note VIEs. The firm structures VIEs that issue principal-protected notes to clients. These VIEs own portfolios of assets, principally with exposure to hedge funds. Substantially all of the principal protection on the notes issued by these VIEs is provided by the asset portfolio rebalancing that is required under the terms of the notes. The firm enters into total return swaps with these VIEs under which the firm pays the VIE the return due to the principal-protected note holders and receives the return on the assets owned by the VIE. The firm may enter into derivatives with other counterparties to mitigate the risk it has from the derivatives it enters into with these VIEs. The firm also obtains funding through these VIEs.

Table of Contents

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

VIE Consolidation Analysis

A variable interest in a VIE is an investment (e.g., debt or equity securities) or other interest (e.g., derivatives or loans and lending commitments) in a VIE that will absorb portions of the VIE s expected losses and/or receive portions of the VIE s expected residual returns.

The firm s variable interests in VIEs include senior and subordinated debt in residential and commercial mortgage-backed and other asset-backed securitization entities, CDOs and CLOs; loans and lending commitments; limited and general partnership interests; preferred and common equity; derivatives that may include foreign currency, equity and/or credit risk; guarantees; and certain of the fees the firm receives from investment funds. Certain interest rate, foreign currency and credit derivatives the firm enters into with VIEs are not variable interests because they create rather than absorb risk.

The enterprise with a controlling financial interest in a VIE is known as the primary beneficiary and consolidates the VIE. The firm determines whether it is the primary beneficiary of a VIE by performing an analysis that principally considers:

- which variable interest holder has the power to direct the activities of the VIE that most significantly impact the VIE s economic performance;
- which variable interest holder has the obligation to absorb losses or the right to receive benefits from the VIE that could potentially be significant to the VIE;
- the VIE s purpose and design, including the risks the VIE was designed to create and pass through to its variable interest holders;
- the VIE s capital structure;
- the terms between the VIE and its variable interest holders and other parties involved with the VIE; and
- related-party relationships.

The firm reassesses its initial evaluation of whether an entity is a VIE when certain reconsideration events occur. The firm reassesses its determination of whether it is the primary beneficiary of a VIE on an ongoing basis based on current facts and circumstances.

Nonconsolidated VIEs

The firm s exposure to the obligations of VIEs is generally limited to its interests in these entities. In certain instances, the firm provides guarantees, including derivative guarantees, to VIEs or holders of variable interests in VIEs.

The tables below present information about nonconsolidated VIEs in which the firm holds variable interests. Nonconsolidated VIEs are aggregated based on principal business activity. The nature of the firm s variable interests can take different forms, as described in the rows under maximum exposure to loss. In the tables below:

The maximum exposure to loss excludes the benefit of offsetting financial instruments that are held to mitigate the risks associated with these variable interests.

For retained and purchased interests and loans and investments, the maximum exposure to loss is the carrying value of these interests.

For commitments and guarantees, and derivatives, the maximum exposure to loss is the notional amount, which does not represent anticipated losses and also has not been reduced by unrealized losses already recorded. As a result, the maximum exposure to loss exceeds liabilities recorded for commitments and guarantees, and derivatives provided to VIEs.

The carrying values of the firm s variable interests in nonconsolidated VIEs are included in the consolidated statement of financial condition as follows:

Substantially all assets held by the firm related to mortgage-backed, corporate CDO and CLO and ons-serif;font-size:9pt;">%

11

%

Research and Development

The growth in R&D expense during the third quarter and first nine months of 2017 compared to the same periods in 2016 was driven primarily by an increase in headcount-related expenses to support expanded R&D activities. The Company continues to believe that focused investments in R&D are critical to its future growth and competitive position in the marketplace, and to the development of new and updated products and services that are central to the Company’s core business strategy.

Selling, General and Administrative

The growth in selling, general and administrative expense during the third quarter and first nine months of 2017 compared to the same periods in 2016 was driven primarily by an increase in headcount-related expenses and higher variable selling expenses.

Apple Inc. | Q3 2017 Form 10-Q | 27

Other Income/(Expense), Net

Other income/(expense), net for the three- and nine-month periods ended July 1, 2017 and June 25, 2016 was as follows (dollars in millions):

	Three Months Ended			Nine Months Ended		
	July 1, 2017	June 25, 2016	Change	July 1, 2017	June 25, 2016	Change
Interest and dividend income	$1,327	$1,036		$3,833	$2,963	
Interest expense	(602)	(409)		(1,657)	(1,006)	
Other expense, net	(185)	(263)		(228)	(1,036)	
Total other income/(expense), net	$540	$364	48 %	$1,948	$921	112 %

The increase in other income/(expense), net during the third quarter and first nine months of 2017 compared to the same periods in 2016 was due primarily to higher interest income and the favorable impact of foreign exchange-related items, partially offset by higher interest expense on debt. The weighted-average interest rate earned by the Company on its cash, cash equivalents and marketable securities was 2.03% and 1.77% in the third quarter of 2017 and 2016, respectively, and 1.96% and 1.72% in the first nine months of 2017 and 2016, respectively.

Provision for Income Taxes

Provision for income taxes and effective tax rates for the three- and nine-month periods ended July 1, 2017 and June 25, 2016 were as follows (dollars in millions):

	Three Months Ended		Nine Months Ended	
	July 1, 2017	June 25, 2016	July 1, 2017	June 25, 2016
Provision for income taxes	$2,591	$2,673	$12,535	$12,511
Effective tax rate	22.9 %	25.5 %	25.0 %	25.4 %

The Company’s effective tax rates during the third quarter and first nine months of 2017 and 2016 differ from the statutory federal income tax rate of 35% due primarily to certain undistributed foreign earnings, a substantial portion of which was generated by subsidiaries organized in Ireland, for which no U.S. taxes are provided when such earnings are intended to be indefinitely reinvested outside the U.S. The lower effective tax rates during the third quarter and first nine months of 2017 compared to the same periods in 2016 were due to higher U.S. R&D credits, in part as a result of the resolution of the U.S. Internal Revenue Service (“IRS”) audit of years 2010 through 2012.

The IRS concluded its review of the years 2010 through 2012 during the third quarter of 2017. All years prior to 2013 are closed, and the IRS is currently examining the years 2013 through 2015. The Company is subject to audits by federal, state, local and foreign tax authorities. Management believes that adequate provisions have been made for any adjustments that may result from tax examinations. However, the outcome of tax audits cannot be predicted with certainty. If any issues addressed in the Company’s tax audits are resolved in a manner not consistent with management’s expectations, the Company could be required to adjust its provision for income taxes in the period such resolution occurs.

On August 30, 2016, the European Commission announced its decision that Ireland granted state aid to the Company by providing tax opinions in 1991 and 2007 concerning the tax allocation of profits of the Irish branches of two subsidiaries of the Company (the “State Aid Decision”). The State Aid Decision orders Ireland to calculate and recover additional taxes from the Company for the period June 2003 through December 2014. Irish legislative changes, effective as of January 2015, eliminated the application of the tax opinions from that date forward. The Company believes the State Aid Decision to be without merit and appealed to the General Court of the Court of Justice of the European Union. Ireland has also appealed the State Aid Decision. While the European Commission announced a recovery amount of up to €13 billion, plus interest, the actual amount of additional taxes subject to recovery is to be calculated by Ireland in accordance with the European Commission’s guidance. Once the recovery amount is computed by Ireland, the Company anticipates funding it, including interest, out of foreign cash into escrow, where it will remain pending conclusion of all appeals. The Company believes that any incremental Irish corporate income taxes potentially due related to the State Aid Decision would be creditable against U.S. taxes.

Recent Accounting Pronouncements

Restricted Cash

In November 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash ("ASU 2016-18"), which enhances and clarifies the guidance on the classification and presentation of restricted cash in the statement of cash flows. The Company will adopt ASU 2016-18 in its first quarter of 2019 utilizing the retrospective adoption method. Currently, the Company's restricted cash balance is not significant.

Income Taxes

In October 2016, the FASB issued ASU No. 2016-16, Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory ("ASU 2016-16"), which requires the recognition of the income tax consequences of an intra-entity transfer of an asset, other than inventory, when the transfer occurs. The Company will adopt ASU 2016-16 in its first quarter of 2019 utilizing the modified retrospective adoption method. Currently, the Company anticipates recording up to $9 billion of net deferred tax assets on its Consolidated Balance Sheets. However, the ultimate impact of adopting ASU 2016-16 will depend on the balance of intellectual property transferred between its subsidiaries as of the adoption date. The Company will recognize incremental deferred income tax expense thereafter as these deferred tax assets are utilized.

Stock Compensation

In March 2016, the FASB issued ASU No. 2016-09, Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting ("ASU 2016-09"), which modifies certain aspects of the accounting for share-based payment transactions, including income taxes, classification of awards, and classification in the statement of cash flows. The Company will adopt ASU 2016-09 in its first quarter of 2018. Currently, excess tax benefits or deficiencies from the Company's equity awards are recorded as additional paid-in capital in its Consolidated Balance Sheets. Upon adoption, the Company will record any excess tax benefits or deficiencies from its equity awards in its Consolidated Statements of Operations in the reporting periods in which vesting occurs. As a result, subsequent to adoption the Company's income tax expense and associated effective tax rate will be impacted by fluctuations in stock price between the grant dates and vesting dates of equity awards.

Leases

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842) ("ASU 2016-02"), which modifies lease accounting for lessees to increase transparency and comparability by recording lease assets and liabilities for operating leases and disclosing key information about leasing arrangements. ASU 2016-02 will be effective for the Company beginning in its first quarter of 2020, and early adoption is permitted. The Company will use a modified retrospective adoption approach. While the Company is currently evaluating the timing and impact of adopting ASU 2016-02, currently the Company anticipates recording lease assets and liabilities in excess of $8.5 billion on its Consolidated Balance Sheets, with no material impact to its Consolidated Statements of Operations. However, the ultimate impact of adopting ASU 2016-02 will depend on the Company's lease portfolio as of the adoption date.

Financial Instruments

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities ("ASU 2016-01"), which updates certain aspects of recognition, measurement, presentation and disclosure of financial instruments. The Company will adopt ASU 2016-01 in its first quarter of 2019 utilizing the modified retrospective adoption method. Based on the composition of the Company's investment portfolio, the adoption of ASU 2016-01 is not expected to have a material impact on its consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments ("ASU 2016-13"), which modifies the measurement of expected credit losses of certain financial instruments. The Company will adopt ASU 2016-13 in its first quarter of 2021 utilizing the modified retrospective adoption method. Based on the composition of the Company's investment portfolio, current market conditions, and historical credit loss activity, the adoption of ASU 2016-13 is not expected to have a material impact on its consolidated financial statements.

Revenue Recognition

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606) ("ASU 2014-09"), which amends the existing accounting standards for revenue recognition. ASU 2014-09 is based on principles that govern the recognition of revenue at an amount an entity expects to be entitled when products are transferred to customers.

Subsequently, the FASB has issued the following standards related to ASU 2014-09: ASU No. 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations ("ASU 2016-08"); ASU No. 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing ("ASU 2016-10"); ASU No. 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients ("ASU 2016-12"); and ASU No. 2016-20, Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers ("ASU 2016-20"). The Company must adopt ASU 2016-08, ASU 2016-10, ASU 2016-12 and ASU 2016-20 with ASU 2014-09 (collectively, the "new revenue standards").

The new revenue standards may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of adoption. The Company plans to adopt the new revenue standards in its first quarter of 2019 utilizing the full retrospective adoption method. The new revenue standards are not expected to have a material impact on the amount and timing of revenue recognized in the Company's consolidated financial statements.

Liquidity and Capital Resources

The following tables present selected financial information and statistics as of July 1, 2017 and September 24, 2016 and for the first nine months of 2017 and 2016 (in millions):

	July 1, 2017	September 24, 2016
Cash, cash equivalents and marketable securities	$261,516	$ 237,585
Property, plant and equipment, net	$29,286	$ 27,010
Commercial paper	$11,980	$ 8,105
Total term debt	$96,359	$ 78,927
Working capital	$31,573	$ 27,863

	Nine Months Ended	
	July 1, 2017	June 25, 2016
Cash generated by operating activities	$47,942	$49,698
Cash used in investing activities	$(36,504)	$(38,580)
Cash used in financing activities	$(13,351)	$(14,001)

The Company believes its existing balances of cash, cash equivalents and marketable securities will be sufficient to satisfy its working capital needs, capital asset purchases, outstanding commitments and other liquidity requirements associated with its existing operations over the next 12 months. The Company currently anticipates the cash used for future dividends, the share repurchase program and debt repayments will come from its current domestic cash, cash generated from ongoing U.S. operating activities and from borrowings.

As of July 1, 2017 and September 24, 2016, the Company's cash, cash equivalents and marketable securities held by foreign subsidiaries were $246.0 billion and $216.0 billion, respectively, and are generally based in U.S. dollar-denominated holdings. Amounts held by foreign subsidiaries are generally subject to U.S. income taxation on repatriation to the U.S. In connection with the State Aid Decision, the European Commission announced a recovery amount of up to €13 billion, plus interest. The actual amount of additional taxes subject to recovery is to be calculated by Ireland in accordance with the European Commission's guidance. Once the recovery amount is computed by Ireland, the Company anticipates funding it, including interest, out of foreign cash into escrow, where it will remain pending conclusion of all appeals.

The Company's marketable securities investment portfolio is primarily invested in highly-rated securities, and its investment policy generally limits the amount of credit exposure to any one issuer. The policy generally requires investments to be investment grade, with the primary objective of minimizing the potential risk of principal loss.

During the nine months ended July 1, 2017, cash generated by operating activities of $47.9 billion was a result of $37.6 billion of net income, non-cash adjustments to net income of $16.0 billion and a decrease in the net change in operating assets and liabilities of $5.7 billion, which included a one-time payment of $1.9 billion related to a multi-year license agreement. Cash used in investing activities of $36.5 billion during the nine months ended July 1, 2017 consisted primarily of cash used for purchases of marketable securities, net of sales and maturities, of $27.7

billion and cash used to acquire property, plant and equipment of $8.6 billion. Cash used in financing activities of $13.4 billion during the nine months ended July 1, 2017 consisted primarily of cash used to repurchase common stock of $25.1 billion, cash used to pay dividends and dividend equivalents of $9.5 billion and cash used to repay term debt of $3.5 billion, partially offset by proceeds from the issuance of term debt, net of $21.7 billion and proceeds from commercial paper, net of $3.9 billion.

During the nine months ended June 25, 2016, cash generated by operating activities of $49.7 billion was a result of $36.7 billion of net income, non-cash adjustments to net income of $16.7 billion and a decrease in the net change in operating assets and liabilities of $3.7 billion. Cash used in investing activities of $38.6 billion during the nine months ended June 25, 2016 consisted primarily of cash used for purchases of marketable securities, net of sales and maturities, of $27.2 billion and cash used to acquire property, plant and equipment of $8.8 billion. Cash used in financing activities of $14.0 billion during the nine months ended June 25, 2016 consisted primarily of cash used to repurchase common stock of $23.7 billion, cash used to pay dividends and dividend equivalents of $9.1 billion and cash used to repay term debt of $2.5 billion, partially offset by proceeds from the issuance of term debt, net of $18.0 billion and proceeds from commercial paper, net of $4.0 billion.

Capital Assets

The Company’s capital expenditures were $8.5 billion during the first nine months of 2017. The Company anticipates utilizing approximately $15.0 billion for capital expenditures during 2017, which includes product tooling and manufacturing process equipment; data centers; corporate facilities and infrastructure, including information systems hardware, software and enhancements; and retail store facilities.

Debt

The Company issues unsecured short-term promissory notes (“Commercial Paper”) pursuant to a commercial paper program. The Company uses the net proceeds from the commercial paper program for general corporate purposes, including dividends and share repurchases. As of July 1, 2017, the Company had $12.0 billion of Commercial Paper outstanding, with a weighted-average interest rate of 1.01% and maturities generally less than nine months.

As of July 1, 2017, the Company had outstanding floating- and fixed-rate notes with varying maturities for an aggregate principal amount of $96.6 billion (collectively the “Notes”). During the third quarter of 2017, the Company repaid $3.5 billion of its Notes. The Company has entered, and in the future may enter, into interest rate swaps to manage interest rate risk on the Notes. In addition, the Company has entered, and in the future may enter, into foreign currency swaps to manage foreign currency risk on the Notes.

Further information regarding the Company’s debt issuances and related hedging activity can be found in Part I, Item 1 of this Form 10-Q in the Notes to Condensed Consolidated Financial Statements in Note 2, “Financial Instruments” and Note 6, “Debt.”

Capital Return Program

In May 2017, the Company’s Board of Directors increased the total capital return program from $250 billion to $300 billion, which included an increase in the share repurchase authorization from $175 billion to $210 billion of the Company’s common stock. Additionally, the Company announced that the Board of Directors raised the Company’s quarterly cash dividend from $0.57 to $0.63 per share, beginning with the dividend paid during the third quarter of 2017. The Company intends to increase its dividend on an annual basis subject to declaration by the Board of Directors.

As of July 1, 2017, $158 billion of the share repurchase program had been utilized. The Company’s share repurchase program does not obligate it to acquire any specific number of shares. Under the program, shares may be repurchased in privately negotiated or open market transactions, including under plans complying with Rule 10b5-1 under the Exchange Act.

The following table presents the Company’s dividends, dividend equivalents, share repurchases and net share settlement activity from the start of the capital return program in August 2012 through July 1, 2017 (in millions):

	Dividends and Dividend Equivalents Paid	Accelerated Share Repurchases	Open Market Share Repurchases	Taxes Related to Settlement of Equity Awards	Total
Q3 2017	$ 3,365	$ 3,000	$ 4,500	$ 858	$ 11,723
Q2 2017	3,004	3,000	4,001	159	10,164
Q1 2017	3,130	6,000	5,000	629	14,759
2016	12,150	12,000	17,000	1,570	42,720
2015	11,561	6,000	30,026	1,499	49,086
2014	11,126	21,000	24,000	1,158	57,284

2013	10,564	13,950	9,000	1,082	34,596
2012	2,488	—	—	56	2,544
Total	$ 57,388	$ 64,950	$ 93,527	$ 7,011	$222,876

The Company expects to execute its capital return program by the end of March 2019 by paying dividends and dividend equivalents, repurchasing shares and remitting withheld taxes related to net share settlement of restricted stock units. The Company plans to continue to access the domestic and international debt markets to assist in funding its capital return program.

Off-Balance Sheet Arrangements and Contractual Obligations

The Company has not entered into any transactions with unconsolidated entities whereby the Company has financial guarantees, subordinated retained interests, derivative instruments, or other contingent arrangements that expose the Company to material continuing risks, contingent liabilities, or any other obligation under a variable interest in an unconsolidated entity that provides financing, liquidity, market risk, or credit risk support to the Company, or engages in leasing, hedging, or R&D services with the Company.

Operating Leases

As of July 1, 2017, the Company's total future minimum lease payments under noncancelable operating leases were $8.5 billion. The Company's retail store and other facility leases are typically for terms not exceeding 10 years and generally contain multi-year renewal options.

Manufacturing Purchase Obligations

The Company utilizes several outsourcing partners to manufacture sub-assemblies for the Company's products and to perform final assembly and testing of finished products. These outsourcing partners acquire components and build product based on demand information supplied by the Company, which typically covers periods up to 150 days. The Company also obtains individual components for its products from a wide variety of individual suppliers. As of July 1, 2017, the Company expects to pay $23.4 billion under manufacturing-related supplier arrangements, substantially all of which is noncancelable.

Other Purchase Obligations

The Company's other purchase obligations consisted of noncancelable obligations to acquire capital assets, including product tooling and manufacturing process equipment, and noncancelable obligations related to advertising, licensing, R&D, internet and telecommunications services and other obligations. As of July 1, 2017, the Company had other purchase obligations of $9.0 billion.

The Company's other non-current liabilities in the Condensed Consolidated Balance Sheets consist primarily of deferred tax liabilities, gross unrecognized tax benefits and the related gross interest and penalties. As of July 1, 2017, the Company had non-current deferred tax liabilities of $30.2 billion, gross unrecognized tax benefits of $8.6 billion and an additional $1.3 billion for gross interest and penalties.

Indemnification

Agreements entered into by the Company sometimes include indemnification provisions which may subject the Company to costs and damages in the event of a claim against an indemnified third party. In the opinion of management, there was not at least a reasonable possibility the Company may have incurred a material loss, or a material loss in excess of a recorded accrual, with respect to indemnification of third parties.

The Company offers an iPhone Upgrade Program, which is available to customers who purchase a qualifying iPhone in the U.S., the U.K. and mainland China. The iPhone Upgrade Program provides customers the right to trade in that iPhone for a specified amount when purchasing a new iPhone, provided certain conditions are met. The Company accounts for the trade-in right as a guarantee liability and recognizes arrangement revenue net of the fair value of such right with subsequent changes to the guarantee liability recognized within revenue.

The Company has entered into indemnification agreements with its directors and executive officers. Under these agreements, the Company has agreed to indemnify such individuals to the fullest extent permitted by law against liabilities that arise by reason of their status as directors or officers of the Company and to advance expenses incurred by such individuals in connection with related legal proceedings. It is not possible to determine the maximum potential amount of payments the Company could be required to make under these agreements due to the limited history of prior indemnification claims and the unique facts and circumstances involved in each claim. While the Company maintains directors and officers liability insurance coverage, such insurance coverage may be insufficient to cover all losses or all types of claims that may arise.

Critical Accounting Policies and Estimates

The preparation of financial statements and related disclosures in conformity with U.S. generally accepted accounting principles and the Company's discussion and analysis of its financial condition and operating results require the Company's management to make judgments, assumptions and estimates that affect the amounts reported in its condensed consolidated financial statements and accompanying notes. Management bases its estimates on historical experience and on various other assumptions it believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ from these estimates, and such differences may be material.

Note 1, "Summary of Significant Accounting Policies" in Part I, Item 1 of this Form 10-Q and in the Notes to Consolidated Financial Statements in Part II, Item 8 of the 2016 Form 10-K, and "Critical Accounting Policies and Estimates" in Part II, Item 7 of the 2016 Form 10-K describe the significant accounting policies and methods used in the preparation of the Company's condensed consolidated financial statements. There have been no material changes to the Company's critical accounting policies and estimates since the 2016 Form 10-K.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes to the Company's market risk during the first nine months of 2017. For a discussion of the Company's exposure to market risk, refer to the Company's market risk disclosures set forth in Part II, Item 7A, "Quantitative and Qualitative Disclosures About Market Risk" of the 2016 Form 10-K.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Based on an evaluation under the supervision and with the participation of the Company's management, the Company's principal executive officer and principal financial officer have concluded that the Company's disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act were effective as of July 1, 2017 to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms and (ii) accumulated and communicated to the Company's management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

There were no changes in the Company's internal control over financial reporting during the third quarter of 2017, which were identified in connection with management's evaluation required by paragraph (d) of Rules 13a-15 and 15d-15 under the Exchange Act, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II — OTHER INFORMATION

Item 1. Legal Proceedings

The Company is subject to legal proceedings and claims that have not been fully resolved and that have arisen in the ordinary course of business. In the opinion of management, there was not at least a reasonable possibility the Company may have incurred a material loss, or a material loss in excess of a recorded accrual, with respect to loss contingencies for asserted legal and other claims. However, the outcome of legal proceedings and claims brought against the Company is subject to significant uncertainty. Therefore, although management considers the likelihood of such an outcome to be remote, if one or more of these legal matters were resolved against the Company in a reporting period for amounts in excess of management's expectations, the Company's consolidated financial statements for that reporting period could be materially adversely affected. See the risk factor "The Company could be impacted by unfavorable results of legal proceedings, such as being found to have infringed on intellectual property rights" in Part II, Item 1A of this Form 10-Q under the heading "Risk Factors." The Company settled certain matters during the third quarter of 2017 that did not individually or in the aggregate have a material impact on the Company's financial condition or operating results.

Item 1A. Risk Factors

The following description of risk factors includes any material changes to, and supersedes the description of, risk factors associated with the Company's business previously disclosed in Part I, Item 1A of the 2016 Form 10-K and in Part II, Item 1A of the Forms 10-Q for the quarters ended December 31, 2016 and April 1, 2017, in each case under the heading "Risk Factors." The business, financial condition and operating results of the Company can be affected by a number of factors, whether currently known or unknown, including but not limited to those described below, any one or more of which could, directly or indirectly, cause the Company's actual financial condition and operating results to vary materially from past, or from anticipated future, financial condition and operating results. Any of these factors, in whole or in part, could materially and adversely affect the Company's business, financial condition, operating results and stock price.

The following discussion of risk factors contains forward-looking statements. These risk factors may be important to understanding other statements in this Form 10-Q. The following information should be read in conjunction with the condensed consolidated financial statements and related notes in Part I, Item 1, "Financial Statements" and Part I, Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations" of this Form 10-Q.

Because of the following factors, as well as other factors affecting the Company's financial condition and operating results, past financial performance should not be considered to be a reliable indicator of future performance, and investors should not use historical trends to anticipate results or trends in future periods.

Global and regional economic conditions could materially adversely affect the Company.

The Company's operations and performance depend significantly on global and regional economic conditions. Uncertainty about global and regional economic conditions poses a risk as consumers and businesses may postpone spending in response to tighter credit, higher unemployment, financial market volatility, government austerity programs, negative financial news, declines in income or asset values and/or other factors. These worldwide and regional economic conditions could have a material adverse effect on demand for the Company's products and services. Demand also could differ materially from the Company's expectations as a result of currency fluctuations because the Company generally raises prices on goods and services sold outside the U.S. to correspond with the effect of a strengthening of the U.S. dollar. Other factors that could influence worldwide or regional demand include changes in fuel and other energy costs, conditions in the real estate and mortgage markets, unemployment, labor and healthcare costs, access to credit, consumer confidence and other macroeconomic factors affecting consumer spending behavior. These and other economic factors could materially adversely affect demand for the Company's products and services.

In the event of financial turmoil affecting the banking system and financial markets, additional consolidation of the financial services industry, or significant financial service institution failures, there could be tightening in the credit markets, low liquidity and extreme volatility in fixed income, credit, currency and equity markets. This could have a number of effects on the Company's business, including the insolvency or financial instability of outsourcing partners or suppliers or their inability to obtain credit to finance development and/or manufacture products, resulting in product delays; inability of customers, including channel partners, to obtain credit to finance purchases of the

Company's products; failure of derivative counterparties and other financial institutions; and restrictions on the Company's ability to issue new debt. Other income and expense also could vary materially from expectations depending on gains or losses realized on the sale or exchange of financial instruments; impairment charges resulting from revaluations of debt and equity securities and other investments; changes in interest rates; increases or decreases in cash balances; volatility in foreign exchange rates; and changes in fair value of derivative instruments. Increased volatility in the financial markets and overall economic uncertainty would increase the risk of the actual amounts realized in the future on the Company's financial instruments differing significantly from the fair values currently assigned to them.

Global markets for the Company's products and services are highly competitive and subject to rapid technological change, and the Company may be unable to compete effectively in these markets.

The Company's products and services compete in highly competitive global markets characterized by aggressive price cutting and resulting downward pressure on gross margins, frequent introduction of new products, short product life cycles, evolving industry standards, continual improvement in product price/performance characteristics, rapid adoption of technological and product advancements by competitors and price sensitivity on the part of consumers.

The Company's ability to compete successfully depends heavily on its ability to ensure a continuing and timely introduction of innovative new products, services and technologies to the marketplace. The Company believes it is unique in that it designs and develops nearly the entire solution for its products, including the hardware, operating system, numerous software applications and related services. As a result, the Company must make significant investments in R&D. The Company currently holds a significant number of patents and copyrights and has registered and/or has applied to register numerous patents, trademarks and service marks. In contrast, many of the Company's competitors seek to compete primarily through aggressive pricing and very low cost structures, and emulating the Company's products and infringing on its intellectual property. If the Company is unable to continue to develop and sell innovative new products with attractive margins or if competitors infringe on the Company's intellectual property, the Company's ability to maintain a competitive advantage could be adversely affected.

The Company markets certain mobile communication and media devices based on the iOS mobile operating system and also markets related services, including third-party digital content and applications. The Company faces substantial competition in these markets from companies that have significant technical, marketing, distribution and other resources, as well as established hardware, software and digital content supplier relationships; and the Company has a minority market share in the global smartphone market. Additionally, the Company faces significant price competition as competitors reduce their selling prices and attempt to imitate the Company's product features and applications within their own products or, alternatively, collaborate with each other to offer solutions that are more competitive than those they currently offer. The Company competes with business models that provide content to users for free. The Company also competes with illegitimate means to obtain third-party digital content and applications. Some of the Company's competitors have greater experience, product breadth and distribution channels than the Company. Because some current and potential competitors have substantial resources and/or experience and a lower cost structure, they may be able to provide products and services at little or no profit or even at a loss. The Company also expects competition to intensify as competitors attempt to imitate the Company's approach to providing components seamlessly within their individual offerings or work collaboratively to offer integrated solutions. The Company's financial condition and operating results depend substantially on the Company's ability to continually improve iOS and iOS devices in order to maintain their functional and design advantages.

The Company is the only authorized maker of hardware using macOS, which has a minority market share in the personal computer market. This market has been contracting and is dominated by computer makers using competing operating systems, most notably Windows. In the market for personal computers and accessories, the Company faces a significant number of competitors, many of which have broader product lines, lower-priced products and a larger installed customer base. Historically, consolidation in this market has resulted in larger competitors. Price competition has been particularly intense as competitors have aggressively cut prices and lowered product margins. An increasing number of internet-enabled devices that include software applications and are smaller and simpler than traditional personal computers compete for market share with the Company's existing products. The Company's financial condition and operating results also depend on its ability to continually improve the Mac platform to maintain its functional and design advantages.

There can be no assurance the Company will be able to continue to provide products and services that compete effectively.

To remain competitive and stimulate customer demand, the Company must successfully manage frequent product introductions and transitions.

Due to the highly volatile and competitive nature of the industries in which the Company competes, the Company must continually introduce new products, services and technologies, enhance existing products and services, effectively stimulate customer demand for new and upgraded products and successfully manage the transition to these new and upgraded products. The success of new product introductions depends on a number of factors including, but not limited to, timely and successful product development, market acceptance, the Company’s ability to manage the risks associated with new product production ramp-up issues, the availability of application software for new products, the effective management of purchase commitments and inventory levels in line with anticipated product demand, the availability of products in appropriate quantities and at expected costs to meet anticipated demand and the risk that new products may have quality or other defects or deficiencies in the early stages of introduction. Accordingly, the Company cannot determine in advance the ultimate effect of new product introductions and transitions.

The Company depends on the performance of distributors, carriers and other resellers.

The Company distributes its products through cellular network carriers, wholesalers, national and regional retailers and value-added resellers, many of whom distribute products from competing manufacturers. The Company also sells its products and third-party products in most of its major markets directly to education, enterprise and government customers and consumers and small and mid-sized businesses through its retail and online stores.

Some carriers providing cellular network service for iPhone subsidize users' purchases of the device. There is no assurance that such subsidies will be continued at all or in the same amounts upon renewal of the Company's agreements with these carriers or in agreements the Company enters into with new carriers.

The Company has invested and will continue to invest in programs to enhance reseller sales, including staffing selected resellers' stores with Company employees and contractors, and improving product placement displays. These programs could require a substantial investment while providing no assurance of return or incremental revenue. The financial condition of these resellers could weaken, these resellers could stop distributing the Company's products, or uncertainty regarding demand for some or all of the Company's products could cause resellers to reduce their ordering and marketing of the Company's products.

The Company faces substantial inventory and other asset risk in addition to purchase commitment cancellation risk.

The Company records a write-down for product and component inventories that have become obsolete or exceed anticipated demand or net realizable value and accrues necessary cancellation fee reserves for orders of excess products and components. The Company also reviews its long-lived assets, including capital assets held at its suppliers' facilities and inventory prepayments, for impairment whenever events or circumstances indicate the carrying amount of an asset may not be recoverable. If the Company determines that impairment has occurred, it records a write-down equal to the amount by which the carrying value of the asset exceeds its fair value. Although the Company believes its provisions related to inventory, capital assets, inventory prepayments and other assets and purchase commitments are currently adequate, no assurance can be given that the Company will not incur additional related charges given the rapid and unpredictable pace of product obsolescence in the industries in which the Company competes.

The Company must order components for its products and build inventory in advance of product announcements and shipments. Manufacturing purchase obligations typically cover forecasted component and manufacturing requirements for periods up to 150 days. Because the Company's markets are volatile, competitive and subject to rapid technology and price changes, there is a risk the Company will forecast incorrectly and order or produce excess or insufficient amounts of components or products, or not fully utilize firm purchase commitments.

Future operating results depend upon the Company's ability to obtain components in sufficient quantities on commercially reasonable terms.

Because the Company currently obtains components from single or limited sources, the Company is subject to significant supply and pricing risks. Many components, including those that are available from multiple sources, are at times subject to industry-wide shortages and significant commodity pricing fluctuations. While the Company has entered into agreements for the supply of many components, there can be no assurance that the Company will be able to extend or renew these agreements on similar terms, or at all. A number of suppliers of components may suffer from poor financial conditions, which can lead to business failure for the supplier or consolidation within a particular industry, further limiting the Company's ability to obtain sufficient quantities of components on commercially reasonable terms. The effects of global or regional economic conditions on the Company's suppliers, described in "Global and regional economic conditions could materially adversely affect the Company" above, also could affect the Company's ability to obtain components. Therefore, the Company remains subject to significant risks of supply shortages and price increases.

The Company's new products often utilize custom components available from only one source. When a component or product uses new technologies, initial capacity constraints may exist until the suppliers' yields have matured or manufacturing capacity has increased. Continued availability of these components at acceptable prices, or at all, may be affected for any number of reasons, including if those suppliers decide to concentrate on the production of common components instead of components customized to meet the Company's requirements. The supply of components for a new or existing product could be delayed or constrained, or a key manufacturing vendor could delay shipments of completed products to the Company.

The Company depends on component and product manufacturing and logistical services provided by outsourcing partners, many of which are located outside of the U.S.

Substantially all of the Company's manufacturing is performed in whole or in part by a few outsourcing partners located primarily in Asia. The Company has also outsourced much of its transportation and logistics management. While these arrangements may lower operating costs, they also reduce the Company's direct control over production and distribution. It is uncertain what effect such diminished control will have on the quality or quantity of products or services, or the Company's flexibility to respond to changing conditions. Although arrangements with these partners may contain provisions for warranty expense reimbursement, the Company may remain responsible to the consumer for warranty service in the event of product defects and could experience an unanticipated product defect or warranty liability. While the Company relies on its partners to adhere to its supplier code of conduct, material violations of the supplier code of conduct could occur.

The Company relies on sole-sourced outsourcing partners in the U.S., Asia and Europe to supply and manufacture many critical components, and on outsourcing partners primarily located in Asia, for final assembly of substantially all of the Company's hardware products. Any failure of these partners to perform may have a negative impact on the Company's cost or supply of components or finished goods. In addition, manufacturing or logistics in these locations or transit to final destinations may be disrupted for a variety of reasons including, but not limited to, natural and man-made disasters, information technology system failures, commercial disputes, military actions or economic, business, labor, environmental, public health, or political issues.

The Company has invested in manufacturing process equipment, much of which is held at certain of its outsourcing partners, and has made prepayments to certain of its suppliers associated with long-term supply agreements. While these arrangements help ensure the supply of components and finished goods, if these outsourcing partners or suppliers experience severe financial problems or other disruptions in their business, such continued supply could be reduced or terminated and the net realizable value of these assets could be negatively impacted.

The Company's products and services may experience quality problems from time to time that can result in decreased sales and operating margin and harm to the Company's reputation.

The Company sells complex hardware and software products and services that can contain design and manufacturing defects. Sophisticated operating system software and applications, such as those sold by the Company, often contain "bugs" that can unexpectedly interfere with the software's intended operation. The Company's online services may from time to time experience outages, service slowdowns or errors. Defects may also occur in components and products the Company purchases from third parties. There can be no assurance the Company will be able to detect and fix all defects in the hardware, software and services it sells. Failure to do so could result in lost revenue, significant warranty and other expenses and harm to the Company's reputation.

The Company relies on access to third-party digital content, which may not be available to the Company on commercially reasonable terms or at all.

The Company contracts with numerous third parties to offer their digital content to customers. This includes the right to sell currently available music, movies, TV shows and books. The licensing or other distribution arrangements with these third parties are for relatively short terms and do not guarantee the continuation or renewal of these arrangements on reasonable terms, if at all. Some third-party content providers and distributors currently or in the future may offer competing products and services, and could take action to make it more difficult or impossible for the Company to license or otherwise distribute their content in the future. Other content owners, providers or distributors may seek to limit the Company's access to, or increase the cost of, such content. The Company may be unable to continue to offer a wide variety of content at reasonable prices with acceptable usage rules, or continue to expand its geographic reach. Failure to obtain the right to make third-party digital content available, or to make such content available on commercially reasonable terms, could have a material adverse impact on the Company's financial condition and operating results.

Some third-party digital content providers require the Company to provide digital rights management and other security solutions. If requirements change, the Company may have to develop or license new technology to provide these solutions. There is no assurance the Company will be able to develop or license such solutions at a reasonable cost and in a timely manner. In addition, certain countries have passed or may propose and adopt legislation that would force the Company to license its digital rights management, which could lessen the protection of content and subject it to piracy and also could negatively affect arrangements with the Company's content providers.

The Company's future performance depends in part on support from third-party software developers.

The Company believes decisions by customers to purchase its hardware products depend in part on the availability of third-party software applications and services. There is no assurance that third-party developers will continue to develop and maintain software applications and services for the Company's products. If third-party software applications and services cease to be developed and maintained for the Company's products, customers may choose not to buy the Company's products.

With respect to its Mac products, the Company believes the availability of third-party software applications and services depends in part on the developers' perception and analysis of the relative benefits of developing, maintaining and upgrading such software for the Company's products compared to Windows-based products. This analysis may be based on factors such as the market position of the Company and its products, the anticipated revenue that may be generated, expected future growth of Mac sales and the costs of developing such applications and services. If the Company's minority share of the global personal computer market causes developers to question the Mac's prospects, developers could be less inclined to develop or upgrade software for the Company's Mac products and more inclined to devote their resources to developing and upgrading software for the larger Windows market.

With respect to iOS devices, the Company relies on the continued availability and development of compelling and innovative software applications, including applications distributed through the App Store. iOS devices are subject to rapid technological change, and, if third-party developers are unable to or choose not to keep up with this pace of change, third-party applications might not successfully operate and may result in dissatisfied customers. As with applications for the Company's Mac products, the availability and development of these applications also depend on developers' perceptions and analysis of the relative benefits of developing, maintaining or upgrading software for the Company's iOS devices rather than its competitors' platforms, such as Android. If developers focus their efforts on these competing platforms, the availability and quality of applications for the Company's iOS devices may suffer.

The Company relies on access to third-party intellectual property, which may not be available to the Company on commercially reasonable terms or at all.

Many of the Company's products include third-party intellectual property, which requires licenses from those third parties. Based on past experience and industry practice, the Company believes such licenses generally can be obtained on reasonable terms. There is, however, no assurance that the necessary licenses can be obtained on acceptable terms or at all. Failure to obtain the right to use third-party intellectual property, or to use such intellectual property on commercially reasonable terms, could preclude the Company from selling certain products or otherwise have a material adverse impact on the Company's financial condition and operating results.

The Company could be impacted by unfavorable results of legal proceedings, such as being found to have infringed on intellectual property rights.

The Company is subject to various legal proceedings and claims that have arisen in the ordinary course of business and have not yet been fully resolved, and new claims may arise in the future. In addition, agreements entered into by the Company sometimes include indemnification provisions which may subject the Company to costs and damages in the event of a claim against an indemnified third party.

Claims against the Company based on allegations of patent infringement or other violations of intellectual property rights have generally increased over time and may continue to increase. In particular, the Company has historically faced a significant number of patent claims relating to its cellular-enabled products, and new claims may arise in the future. For example, technology and other patent-holding companies frequently assert their patents and seek royalties and often enter into litigation based on allegations of patent infringement or other violations of intellectual property rights. The Company is vigorously defending infringement actions in courts in a number of U.S. jurisdictions and before the U.S. International Trade Commission, as well as internationally in various countries. The plaintiffs in these actions frequently seek injunctions and substantial damages.

Regardless of the merit of particular claims, litigation may be expensive, time-consuming, disruptive to the Company's operations and distracting to management. In recognition of these considerations, the Company may enter into licensing agreements or other arrangements to settle litigation and resolve such disputes. No assurance can be given that such agreements can be obtained on acceptable terms or that litigation will not occur. These agreements may also significantly increase the Company's operating expenses.

In management's opinion, there is not at least a reasonable possibility the Company may have incurred a material loss, or a material loss in excess of a recorded accrual, with respect to loss contingencies, including matters related to infringement of intellectual property rights. However, the outcome of litigation is inherently uncertain.

Although management considers the likelihood of such an outcome to be remote, if one or more legal matters were resolved against the Company or an indemnified third party in a reporting period for amounts in excess of management's expectations, the Company's consolidated financial statements for that reporting period could be materially adversely affected. Further, such an outcome could result in significant compensatory, punitive or trebled monetary damages, disgorgement of revenue or profits, remedial corporate measures or injunctive relief against the Company that could materially adversely affect its financial condition and operating results.

While the Company maintains insurance coverage for certain types of claims, such insurance coverage may be insufficient to cover all losses or all types of claims that may arise.

The Company is subject to laws and regulations worldwide, changes to which could increase the Company's costs and individually or in the aggregate adversely affect the Company's business.

The Company is subject to laws and regulations affecting its domestic and international operations in a number of areas. These U.S. and foreign laws and regulations affect the Company's activities including, but not limited to, in areas of labor, advertising, digital content, consumer protection, real estate, billing, e-commerce, promotions, quality of services, telecommunications, mobile communications and media, television, intellectual property ownership and infringement, tax, import and export requirements, anti-corruption, foreign exchange controls and cash repatriation restrictions, data privacy requirements, anti-competition, environmental, health and safety.

By way of example, laws and regulations related to mobile communications and media devices in the many jurisdictions in which the Company operates are extensive and subject to change. Such changes could include, among others, restrictions on the production, manufacture, distribution and use of devices, locking devices to a carrier's network, or mandating the use of devices on more than one carrier's network. These devices are also subject to certification and regulation by governmental and standardization bodies, as well as by cellular network carriers for use on their networks. These certification processes are extensive and time consuming, and could result in additional testing requirements, product modifications, or delays in product shipment dates, or could preclude the Company from selling certain products.

Compliance with these laws, regulations and similar requirements may be onerous and expensive, and they may be inconsistent from jurisdiction to jurisdiction, further increasing the cost of compliance and doing business. Any such costs, which may rise in the future as a result of changes in these laws and regulations or in their interpretation, could individually or in the aggregate make the Company's products and services less attractive to the Company's customers, delay the introduction of new products in one or more regions, or cause the Company to change or limit its business practices. The Company has implemented policies and procedures designed to ensure compliance with applicable laws and regulations, but there can be no assurance that the Company's employees, contractors, or agents will not violate such laws and regulations or the Company's policies and procedures.

The Company's business is subject to the risks of international operations.

The Company derives a significant portion of its revenue and earnings from its international operations. Compliance with applicable U.S. and foreign laws and regulations, such as import and export requirements, anti-corruption laws, tax laws, foreign exchange controls and cash repatriation restrictions, data privacy requirements, environmental laws, labor laws and anti-competition regulations, increases the costs of doing business in foreign jurisdictions. Although the Company has implemented policies and procedures to comply with these laws and regulations, a violation by the Company's employees, contractors or agents could nevertheless occur. In some cases, compliance with the laws and regulations of one country could violate the laws and regulations of another country. Violations of these laws and regulations could materially adversely affect the Company's brand, international growth efforts and business.

The Company also could be significantly affected by other risks associated with international activities including, but not limited to, economic and labor conditions, increased duties, taxes and other costs and political instability. Margins on sales of the Company's products in foreign countries, and on sales of products that include components obtained from foreign suppliers, could be materially adversely affected by international trade regulations, including duties, tariffs and antidumping penalties. The Company is also exposed to credit and collectability risk on its trade receivables with customers in certain international markets. There can be no assurance the Company can effectively limit its credit risk and avoid losses.

The Company's retail stores have required and will continue to require a substantial investment and commitment of resources and are subject to numerous risks and uncertainties.

The Company's retail stores have required substantial investment in equipment and leasehold improvements, information systems, inventory and personnel. The Company also has entered into substantial operating lease commitments for retail space. Certain stores have been designed and built to serve as high-profile venues to promote brand awareness and serve as vehicles for corporate sales and marketing activities. Because of their unique design elements, locations and size, these stores require substantially more investment than the Company's more typical retail stores. Due to the high cost structure associated with the Company's retail stores, a decline in sales or the closure or poor performance of individual or multiple stores could result in significant lease termination costs, write-offs of equipment and leasehold improvements and severance costs.

Many factors unique to retail operations, some of which are beyond the Company's control, pose risks and uncertainties. These risks and uncertainties include, but are not limited to, macro-economic factors that could have an adverse effect on general retail activity, as well as the Company's inability to manage costs associated with store construction and operation, the Company's failure to manage relationships with its existing retail partners, more challenging environments in managing retail operations outside the U.S., costs associated with unanticipated fluctuations in the value of retail inventory, and the Company's inability to obtain and renew leases in quality retail locations at a reasonable cost.

Investment in new business strategies and acquisitions could disrupt the Company's ongoing business and present risks not originally contemplated.

The Company has invested, and in the future may invest, in new business strategies or acquisitions. Such endeavors may involve significant risks and uncertainties, including distraction of management from current operations, greater than expected liabilities and expenses, inadequate return of capital and unidentified issues not discovered in the Company's due diligence. These new ventures are inherently risky and may not be successful.

The Company's business and reputation may be impacted by information technology system failures or network disruptions.

The Company may be subject to information technology system failures and network disruptions. These may be caused by natural disasters, accidents, power disruptions, telecommunications failures, acts of terrorism or war, computer viruses, physical or electronic break-ins, or other events or disruptions. System redundancy may be ineffective or inadequate, and the Company's disaster recovery planning may not be sufficient for all eventualities. Such failures or disruptions could, among other things, prevent access to the Company's online stores and services, preclude retail store transactions, compromise Company or customer data, and result in delayed or canceled orders. System failures and disruptions could also impede the manufacturing and shipping of products, delivery of online services, transactions processing and financial reporting.

There may be breaches of the Company's information technology systems that materially damage business partner and customer relationships, curtail or otherwise adversely impact access to online stores and services, or subject the Company to significant reputational, financial, legal and operational consequences.

The Company's business requires it to use and store customer, employee and business partner personally identifiable information ("PII"). This may include, among other information, names, addresses, phone numbers, email addresses, contact preferences, tax identification numbers and payment account information. Although malicious attacks to gain access to PII affect many companies across various industries, the Company is at a relatively greater risk of being targeted because of its high profile and the amount of PII it manages.

The Company requires user names and passwords in order to access its information technology systems. The Company also uses encryption and authentication technologies designed to secure the transmission and storage of data and prevent access to Company data or accounts. As with all companies, these security measures are subject to third-party security breaches, employee error, malfeasance, faulty password management or other irregularities. For example, third parties may attempt to fraudulently induce employees or customers into disclosing user names, passwords or other sensitive information, which may in turn be used to access the Company's information technology systems. To help protect customers and the Company, the Company monitors accounts and systems for unusual activity and may freeze accounts under suspicious circumstances, which may result in the delay or loss of customer orders.

The Company devotes significant resources to network security, data encryption and other security measures to protect its systems and data, but these security measures cannot provide absolute security. To the extent the Company was to experience a breach of its systems and was unable to protect sensitive data, such a breach could materially damage business partner and customer relationships, and curtail or otherwise adversely impact access to online stores and services. Moreover, if a computer security breach affects the Company's systems or results in the unauthorized release of PII, the Company's reputation and brand could be materially damaged, use of the Company's products and services could decrease, and the Company could be exposed to a risk of loss or litigation and possible liability. While the Company maintains insurance coverage that, subject to policy terms and conditions and subject to a significant self-insured retention, is designed to address certain aspects of cyber risks, such insurance coverage may be insufficient to cover all losses or all types of claims that may arise in the continually evolving area of cyber risk.
The Company is also subject to payment card association rules and obligations under its contracts with payment card processors. Under these rules and obligations, if information is compromised, the Company could be liable to payment card issuers for associated expenses and penalties. In addition, if the Company fails to follow payment card industry security standards, even if no customer information is compromised, the Company could incur significant fines or experience a significant increase in payment card transaction costs.
The Company's business is subject to a variety of U.S. and international laws, rules, policies and other obligations regarding data protection.
The Company is subject to federal, state and international laws relating to the collection, use, retention, security and transfer of PII. In many cases, these laws apply not only to third-party transactions, but also may restrict transfers of PII among the Company and its international subsidiaries. Several jurisdictions have passed laws in this area, and other jurisdictions are considering imposing additional restrictions. These laws continue to develop and may be inconsistent from jurisdiction to jurisdiction. Complying with emerging and changing international requirements may cause the Company to incur substantial costs or require the Company to change its business practices. Noncompliance could result in significant penalties or legal liability.
The Company makes statements about its use and disclosure of PII through its privacy policy, information provided on its website and press statements. Any failure by the Company to comply with these public statements or with other federal, state or international privacy-related or data protection laws and regulations could result in proceedings against the Company by governmental entities or others. In addition to reputational impacts, penalties could include ongoing audit requirements and significant legal liability.
The Company's success depends largely on the continued service and availability of key personnel.
Much of the Company's future success depends on the continued availability and service of key personnel, including its Chief Executive Officer, executive team and other highly skilled employees. Experienced personnel in the technology industry are in high demand and competition for their talents is intense, especially in Silicon Valley, where most of the Company's key personnel are located.
The Company's business may be impacted by political events, war, terrorism, public health issues, natural disasters and other business interruptions.
War, terrorism, geopolitical uncertainties, public health issues and other business interruptions have caused and could cause damage or disruption to international commerce and the global economy, and thus could have a material adverse effect on the Company, its suppliers, logistics providers, manufacturing vendors and customers, including channel partners. The Company's business operations are subject to interruption by, among others, natural disasters, whether as a result of climate change or otherwise, fire, power shortages, nuclear power plant accidents and other industrial accidents, terrorist attacks and other hostile acts, labor disputes, public health issues and other events beyond its control. Such events could decrease demand for the Company's products, make it difficult or impossible for the Company to make and deliver products to its customers, including channel partners, or to receive components from its suppliers, and create delays and inefficiencies in the Company's supply chain. While the Company's suppliers are required to maintain safe working environments and operations, an industrial accident could occur and could result in disruption to the Company's business and harm to the Company's reputation. Should major public health issues, including pandemics, arise, the Company could be adversely affected by more stringent employee travel restrictions, additional limitations in freight services, governmental actions limiting the movement of products between regions, delays in production ramps of new products and disruptions in the operations of the Company's manufacturing vendors

and component suppliers. The majority of the Company’s R&D activities, its corporate headquarters, information technology systems and other critical business operations, including certain component suppliers and manufacturing vendors, are in locations that could be affected by natural disasters. In the event of a natural disaster, the Company could incur significant losses, require substantial recovery time and experience significant expenditures in order to resume operations.

The Company expects its quarterly revenue and operating results to fluctuate.

The Company's profit margins vary across its products and distribution channels. The Company's software, accessories, and service and support contracts generally have higher gross margins than certain of the Company's other products. Gross margins on the Company's hardware products vary across product lines and can change over time as a result of product transitions, pricing and configuration changes, and component, warranty, and other cost fluctuations. The Company's direct sales generally have higher associated gross margins than its indirect sales through its channel partners. In addition, the Company's gross margin and operating margin percentages, as well as overall profitability, may be materially adversely impacted as a result of a shift in product, geographic or channel mix, component cost increases, the strengthening U.S. dollar, price competition, or the introduction of new products, including those that have higher cost structures with flat or reduced pricing.

The Company has typically experienced higher net sales in its first quarter compared to other quarters due in part to seasonal holiday demand. Additionally, new product introductions can significantly impact net sales, product costs and operating expenses. Further, the Company generates a majority of its net sales from a single product and a decline in demand for that product could significantly impact quarterly net sales. The Company could also be subject to unexpected developments late in a quarter, such as lower-than-anticipated demand for the Company's products, issues with new product introductions, an internal systems failure, or failure of one of the Company's logistics, components supply, or manufacturing partners.

The Company's stock price is subject to volatility.

The Company's stock price has experienced substantial price volatility in the past and may continue to do so in the future. Additionally, the Company, the technology industry and the stock market as a whole have experienced extreme stock price and volume fluctuations that have affected stock prices in ways that may have been unrelated to these companies' operating performance. Price volatility over a given period may cause the average price at which the Company repurchases its own stock to exceed the stock's price at a given point in time. The Company believes its stock price should reflect expectations of future growth and profitability. The Company also believes its stock price should reflect expectations that its cash dividend will continue at current levels or grow and that its current share repurchase program will be fully consummated. Future dividends are subject to declaration by the Company's Board of Directors, and the Company's share repurchase program does not obligate it to acquire any specific number of shares. If the Company fails to meet expectations related to future growth, profitability, dividends, share repurchases or other market expectations, its stock price may decline significantly, which could have a material adverse impact on investor confidence and employee retention.

The Company's financial performance is subject to risks associated with changes in the value of the U.S. dollar versus local currencies.

The Company's primary exposure to movements in foreign currency exchange rates relates to non-U.S. dollar-denominated sales and operating expenses worldwide. Weakening of foreign currencies relative to the U.S. dollar adversely affects the U.S. dollar value of the Company's foreign currency-denominated sales and earnings, and generally leads the Company to raise international pricing, potentially reducing demand for the Company's products. Margins on sales of the Company's products in foreign countries and on sales of products that include components obtained from foreign suppliers, could be materially adversely affected by foreign currency exchange rate fluctuations. In some circumstances, for competitive or other reasons, the Company may decide not to raise local prices to fully offset the dollar's strengthening, or at all, which would adversely affect the U.S. dollar value of the Company's foreign currency-denominated sales and earnings. Conversely, a strengthening of foreign currencies relative to the U.S. dollar, while generally beneficial to the Company's foreign currency-denominated sales and earnings, could cause the Company to reduce international pricing and incur losses on its foreign currency derivative instruments, thereby limiting the benefit. Additionally, strengthening of foreign currencies may also increase the Company's cost of product components denominated in those currencies, thus adversely affecting gross margins.

The Company uses derivative instruments, such as foreign currency forward and option contracts, to hedge certain exposures to fluctuations in foreign currency exchange rates. The use of such hedging activities may not offset any, or more than a portion, of the adverse financial effects of unfavorable movements in foreign exchange rates over the limited time the hedges are in place.

The Company is exposed to credit risk and fluctuations in the market values of its investment portfolio.

Given the global nature of its business, the Company has both domestic and international investments. Credit ratings and pricing of the Company's investments can be negatively affected by liquidity, credit deterioration, financial results, economic risk, political risk, sovereign risk or other factors. As a result, the value and liquidity of the Company's cash, cash equivalents and marketable securities may fluctuate substantially. Therefore, although the Company has not realized any significant losses on its cash, cash equivalents and marketable securities, future fluctuations in their value could result in significant realized losses.

The Company is exposed to credit risk on its trade accounts receivable, vendor non-trade receivables and prepayments related to long-term supply agreements, and this risk is heightened during periods when economic conditions worsen. The Company distributes its products through third-party cellular network carriers, wholesalers, retailers and value-added resellers. The Company also sells its products directly to small and mid-sized businesses and education, enterprise and government customers. A substantial majority of the Company’s outstanding trade receivables are not covered by collateral, third-party financing arrangements or credit insurance. The Company’s exposure to credit and collectability risk on its trade receivables is higher in certain international markets and its ability to mitigate such risks may be limited. The Company also has unsecured vendor non-trade receivables resulting from purchases of components by outsourcing partners and other vendors that manufacture sub-assemblies or assemble final products for the Company. In addition, the Company has made prepayments associated with long-term supply agreements to secure supply of inventory components. As of July 1, 2017, a significant portion of the Company’s trade receivables was concentrated within cellular network carriers, and its vendor non-trade receivables and prepayments related to long-term supply agreements were concentrated among a few individual vendors located primarily in Asia. While the Company has procedures to monitor and limit exposure to credit risk on its trade and vendor non-trade receivables, as well as long-term prepayments, there can be no assurance such procedures will effectively limit its credit risk and avoid losses.

The Company could be subject to changes in its tax rates, the adoption of new U.S. or international tax legislation or exposure to additional tax liabilities.

The Company is subject to taxes in the U.S. and numerous foreign jurisdictions, including Ireland, where a number of the Company’s subsidiaries are organized. Due to economic and political conditions, tax rates in various jurisdictions may be subject to significant change. The Company’s effective tax rates could be affected by changes in the mix of earnings in countries with differing statutory tax rates, changes in the valuation of deferred tax assets and liabilities, or changes in tax laws or their interpretation, including in the U.S. and Ireland.

The Company is also subject to the examination of its tax returns and other tax matters by the IRS and other tax authorities and governmental bodies. The Company regularly assesses the likelihood of an adverse outcome resulting from these examinations to determine the adequacy of its provision for taxes. There can be no assurance as to the outcome of these examinations. If the Company’s effective tax rates were to increase, particularly in the U.S. or Ireland, or if the ultimate determination of the Company’s taxes owed is for an amount in excess of amounts previously accrued, the Company’s financial condition, operating results and cash flows could be adversely affected.

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

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

Share repurchase activity during the three months ended July 1, 2017 was as follows (in millions, except number of shares, which are reflected in thousands, and per share amounts):

Periods	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares That May Yet Be Purchased Under the Plans or Programs (1)
April 2, 2017 to May 6, 2017:				
Open market and privately negotiated purchases	6,968	$143.52	6,968	
May 7, 2017 to June 3, 2017:				
February 2017 ASR	3,422	(2)	3,422	
May 2017 ASR	15,598 (3)	(3)	15,598 (3)	
Open market and privately negotiated purchases	10,650	$153.65	10,650	
June 4, 2017 to July 1, 2017:				
Open market and privately negotiated purchases	12,738	$146.31	12,738	
Total	49,376			$ 51,523

(1) In May 2017, the Company's Board of Directors increased the share repurchase authorization from $175 billion to $210 billion of the Company's common stock, of which $158 billion had been utilized as of July 1, 2017. The remaining $52 billion in the table represents the amount available to repurchase shares under the authorized repurchase program as of July 1, 2017. The Company's share repurchase program does not obligate it to acquire any specific number of shares. Under the program, shares may be repurchased in privately negotiated and/or open market transactions, including under plans complying with Rule 10b5-1 under the Exchange Act.

(2) In February 2017, the Company entered into an accelerated share repurchase arrangement ("ASR") to purchase up to $3.0 billion of the Company's common stock. In May 2017, the purchase period for this ASR ended and an additional 3.4 million shares were delivered and retired. In total, 20.9 million shares were delivered under this ASR at an average repurchase price of $143.20.

(3) In May 2017, the Company entered into a new ASR to purchase up to $3.0 billion of the Company's common stock. In exchange for an up-front payment of $3.0 billion, the financial institution party to the arrangement committed to deliver shares to the Company during the ASR's purchase period, which will end in August 2017. The total number of shares ultimately delivered, and therefore the average price paid per share, will be determined at the end of the applicable purchase period based on the volume-weighted average price of the Company's common stock during that period.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits
Exhibit Index

Exhibit Number	Exhibit Description	Incorporated by Reference Form	Exhibit	Filing Date/ Period End Date
4.1	Officer's Certificate of the Registrant, dated as of May 11, 2017, including forms of global notes representing the Floating Rate Notes due 2020, Floating Rate Notes due 2022, 1.800% Notes due 2020, 2.300% Notes due 2022, 2.850% Notes due 2024 and 3.200% Notes due 2027.	8-K	4.1	5/11/17
4.2	Officer's Certificate of the Registrant, dated as of May 24, 2017, including forms of global notes representing the 0.875% Notes due 2025 and 1.375% Notes due 2029.	8-K	4.1	5/24/17
4.3	Officer's Certificate of the Registrant, dated as of June 20, 2017, including form of global note representing the 3.000% Notes due 2027.	8-K	4.1	6/20/17
31.1*	Rule 13a-14(a) / 15d-14(a) Certification of Chief Executive Officer.			
31.2*	Rule 13a-14(a) / 15d-14(a) Certification of Chief Financial Officer.			
32.1**	Section 1350 Certifications of Chief Executive Officer and Chief Financial Officer.			
101.INS*	XBRL Instance Document.			
101.SCH*	XBRL Taxonomy Extension Schema Document.			
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document.			
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document.			
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document.			
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document.			

*Filed herewith.
**Furnished herewith.

SIGNATURE

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

August 2, 2017 Apple Inc.

By: /s/ Luca Maestri
Luca Maestri
Senior Vice President,
Chief Financial Officer