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

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ANNUAL AUDITED REPORT
FORM X-17A-5
PART III

FEB 27 2002
WASH D.C. 340

FACING PAGE
Information Required of Brokers and Dealers Pursuant to Section 17 of the
Securities Exchange Act of 1934 and Rule 17a-5 Thereunder

REPORT FOR THE PERIOD BEGINNING 01/01/2001 AND ENDING 12/31/2001
MM/DD/YY MM/DD/YY

A. REGISTRANT IDENTIFICATION

NAME OF BROKER-DEALER:

Jefferies & Company, Inc.

OFFICIAL USE ONLY
FIRM ID. NO.

ADDRESS OF PRINCIPAL PLACE OF BUSINESS: (Do not use P.O. Box No.)

11100 Santa Monica Boulevard

(No. and Street)

Los Angeles

California

90025

(City)

(State)

(Zip Code)

NAME AND TELEPHONE NUMBER OF PERSON TO CONTACT IN REGARD TO THIS REPORT

Maxine Syrjamaki

(310) 914-6034

(Area Code - Telephone No.)

B. ACCOUNTANT IDENTIFICATION

INDEPENDENT PUBLIC ACCOUNTANT whose opinion is contained in this Report*

KPMG LLP

(Name - if individual, state last, first, middle name)

355 South Grand Avenue

Los Angeles

California

90071

(Address)

(City)

(State)

(Zip Code)

CHECK ONE:

- Certified Public Accountant
- Public Accountant
- Accountant not resident in United States or any of its possessions.

PROCESSED

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THOMSON
FINANCIAL

*Claims for exemption from the requirement that the annual report be covered by the opinion of an independent public accountant must be supported by a statement of facts and circumstances relied on as the basis for the exemption. See section 240.17a-5(e)(2).

Vf
3-26-02

OATH OR AFFIRMATION

I, Maxine Syrjamaki, swear (or affirm) that, to the best of my knowledge and belief the accompanying financial statement and supporting schedules pertaining to the firm of Jefferies & Company, Inc. as of December 31, 2001, are true and correct. I further swear (or affirm) that neither the company nor any partner, proprietor, principal officer or director has any proprietary interest in any account classified solely as that of a customer, except as follows:

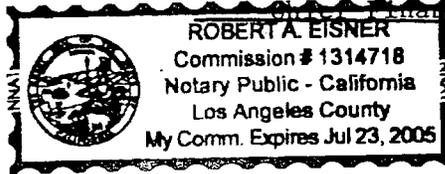
None

State of California
County of Los Angeles
Subscribed and sworn to before me
this 15th day of February, 2002.

Maxine Syrjamaki
Signature

Signature

Notary Public



Financial Officer

Title

This report** contains (check all applicable boxes):

- (a) Facing page.
(b) Statement of Financial Condition.
(c) Statement of Income (Loss).
(d) Statement of Changes in Financial Condition.
(e) Statement of Changes in Stockholders' Equity or Partners' or Sole Proprietor's Capital.
(f) Statement of Changes in Liabilities Subordinated to Claims of Creditors.
(g) Computation of Net Capital
(h) Computation for Determination of Reserve Requirements Pursuant to Rule 15c3-3.
(i) Information Relating to the Possession or control Requirements Under Rule 15c3-3.
(j) A Reconciliation, including appropriate explanation, of the Computation of Net Capital Under Rule 15c3-1 and the Computation for Determination of the Reserve Requirements Under Exhibit A of Rule 15c3-3.
(k) A Reconciliation between the audited and unaudited Statements of Financial Condition with respect to methods of consolidation.
(l) An Oath or Affirmation.
(m) A copy of the SIPC Supplemental Report.
(n) A report describing any material inadequacies found to exist or found to have existed since the date of the previous audit.

**For conditions of confidential treatment of certain portions of this filing, see section 240.17a-5(e)(3).



355 South Grand Avenue
Suite 2000
Los Angeles, CA 90071-1568

INDEPENDENT AUDITORS' REPORT

The Board of Directors
Jefferies & Company, Inc.:

We have audited the accompanying consolidated statement of financial condition of Jefferies & Company, Inc. and subsidiary (the Company) as of December 31, 2001. This consolidated financial statement is the responsibility of the Company's management. Our responsibility is to express an opinion on this consolidated financial statement based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated statement of financial condition is free of material misstatement. An audit of a consolidated statement of financial condition includes examining, on a test basis, evidence supporting the amounts and disclosures in that statement of financial condition. An audit of a statement of financial condition also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall statement of financial condition presentation. We believe that our audit of the consolidated statement of financial condition provides a reasonable basis for our opinion.

In our opinion, the consolidated statement of financial condition referred to above presents fairly, in all material respects, the financial position of Jefferies & Company, Inc. and subsidiary as of December 31, 2001, in conformity with accounting principles generally accepted in the United States of America.

KPMG LLP

January 24, 2002



JEFFERIES & COMPANY, INC. AND SUBSIDIARY

Consolidated Statement of Financial Condition

December 31, 2001

(Dollars in thousands, except per share amounts)

Assets

Cash and cash equivalents	\$	168,887
Cash and securities segregated and on deposit for regulatory purposes or deposited with clearing and depository organizations		153,672
Receivable from brokers and dealers		4,030,669
Receivable from customers, officers and directors		126,395
Securities owned		187,636
Securities pledged to creditors		100,262
Investments		157,062
Premises and equipment		42,720
Due from affiliates		43,977
Exchange memberships, at cost (market value of \$1,460)		1,375
Other assets		122,327
	\$	<u>5,134,982</u>

Liabilities and Stockholder's Equity

Payable to brokers and dealers	\$	3,866,776
Payable to customers		323,207
Securities sold, not yet purchased		73,232
Accrued expenses and other liabilities		250,826
Due to affiliates		9,698
		<u>4,523,739</u>
Stockholder's equity:		
Class A common stock of \$.10 par value. Authorized, issued and outstanding 11,000 shares		1
Additional paid-in capital		251,941
Retained earnings		359,301
Total stockholder's equity		<u>611,243</u>
	\$	<u>5,134,982</u>

See accompanying notes to consolidated statement of financial condition.

JEFFERIES & COMPANY, INC. AND SUBSIDIARY

Notes to Consolidated Statement of Financial Condition

December 31, 2001

(1) Summary of Significant Accounting Policies

Principles of Consolidation

The accompanying consolidated statement of financial condition includes the accounts of Jefferies & Company, Inc. (the "Company") and its wholly owned subsidiary, Jefferies Licensing Corporation. Jefferies & Company, Inc. is registered as a broker-dealer in securities under the Securities Exchange Act of 1934 and is a wholly owned subsidiary of Jefferies Group, Inc. ("Parent").

The Company was founded in 1962 and is engaged as an international investment bank that focuses on capital raising, research, mergers and acquisitions, advisory and restructuring services for small- to medium-sized companies and trading in equity and high yield securities, convertible bonds, options, futures and international securities primarily for institutional clients. The Company is one of the leading national firms engaged in the distribution and trading of blocks of equity securities and conducts such activities primarily in the "third market." The term "third market" refers to transactions in listed equity securities effected away from national securities exchanges. The Company's revenues are derived primarily from commission revenues and market-making or trading as principal in equity, taxable fixed income and convertible securities with or on behalf of institutional investors, with the balance generated by corporate finance and other activities.

All significant intercompany accounts and transactions are eliminated in consolidation.

Securities Transactions

Transactions in securities, commission revenues and related expenses are recorded on a trade-date basis.

Securities owned, securities pledged to creditors, and securities sold, not yet purchased, are valued at market, and unrealized gains or losses are reflected in revenues from principal transactions.

Receivable from, and Payable to, Customers, Officers and Directors

Receivable from, and payable to, customers includes amounts receivable and payable on cash and margin transactions. Securities owned by customers and held as collateral for these receivables are not reflected in the consolidated financial statements. Receivable from officers and directors represents balances arising from their individual security transactions. Such transactions are subject to the same regulations as customer transactions.

Fair Value of Financial Instruments

Substantially all of the Company's financial instruments are carried at fair value or amounts approximating fair value. Assets, including cash and cash equivalents, securities borrowed or purchased under agreements to sell, and certain receivables, are carried at fair value or contracted amounts which approximate fair value due to the short period to maturity. Similarly, liabilities, including bank loans, securities loaned or sold under agreements to repurchase, subordinated

JEFFERIES & COMPANY, INC. AND SUBSIDIARY

Notes to Consolidated Statement of Financial Condition, Continued

December 31, 2001

liabilities and certain payables, are carried at amounts approximating fair value. Securities owned and securities sold, not yet purchased are valued at quoted market prices, if available. For securities without quoted prices, the reported fair value is estimated by using various sources of information, including quoted prices for comparable securities.

The Company has derivative financial instrument positions in option contracts, foreign exchange forward contracts and index futures contracts, which are measured at fair value with gains and losses recognized in earnings. The gross contracted or notional amount of these contracts is not reflected in the consolidated statement of financial condition and is not material in amount (see note 10 of the notes to consolidated statement of financial condition).

Investments

Partnership interests are recorded at their initial cost. The carrying values of these investments are adjusted when the adjustment can be supported by quoted market prices, adjusted for liquidity and other relevant factors. In addition, the carrying values are reduced when the Company determines that the estimated realizable value is less than the carrying value based on relevant financial and market information.

Debt and equity investments consist primarily of mutual funds, which are valued at market, based on available quoted prices.

Equity and debt interests in affiliates are recorded under either the equity or cost method depending on the Company's level of ownership and control.

Premises and Equipment

Premises and equipment are depreciated using the straight-line method over the estimated useful lives of the related assets (generally three to ten years). Leasehold improvements are amortized using the straight-line method over the term of related leases or the estimated useful lives of the assets, whichever is shorter.

Income Taxes

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Cash and Cash Equivalents

Cash equivalents consist of money market funds and other short-term investments, which are part of the cash management activities of the Company and generally mature within 90 days. At December 31, 2001, such cash equivalents amounted to \$135,333,000.

JEFFERIES & COMPANY, INC. AND SUBSIDIARY

Notes to Consolidated Statement of Financial Condition, Continued

December 31, 2001

Cash and Securities Segregated and on Deposit for Regulatory Purposes or Deposited with Clearing and Depository Organizations

Cash and securities segregated and on deposit for regulatory purposes or deposited with clearing and depository organizations mainly consists of reverse repurchase agreements and other deposits. At December 31, 2001, such reverse repurchase agreements amounted to \$137,000,000.

Securities Borrowed and Securities Loaned

In connection with both its trading and brokerage activities, the Company borrows securities to cover short sales and to complete transactions in which customers have failed to deliver securities by the required settlement date, and lends securities to other brokers and dealers for similar purposes. The Company has an active securities borrowed and lending matched book business ("Matched Book"), in which it borrows securities from one party and lends them to another party. When the Company borrows securities, it provides cash to the lender as collateral, which is reflected in the Company's consolidated financial statements as receivable from brokers and dealers. The Company earns interest revenues on this cash collateral. Similarly, when the Company lends securities to another party, that party provides cash to the Company as collateral, which is reflected in the Company's consolidated financial statements as payable to brokers and dealers. The Company pays interest expense on the cash collateral received from the party borrowing the securities. A substantial portion of the Company's interest revenues and interest expense results from the Matched Book activity. The initial collateral advanced or received approximates or is greater than, the fair value of the securities borrowed or loaned. The Company monitors the fair value of the securities borrowed and loaned on a daily basis and requests additional collateral or returns excess collateral, as appropriate.

Repurchase and Reverse Repurchase Agreements

Repurchase agreements consist of sales of U.S. Treasury notes under agreements to repurchase. They are treated as collateralized financing transactions and are recorded at their contracted repurchase amount.

Reverse repurchase agreements consist of purchases of U.S. Treasury notes under agreements to re-sell. They are treated as collateralized financing transactions and are recorded at their contracted re-sale amount.

The Company monitors the fair value of the securities purchased and sold under these agreements daily versus the related receivable or payable balances. Should the fair value of the securities purchased decline or the fair value of the securities sold increase, additional collateral is requested or excess collateral is returned, as appropriate.

New Accounting Standard on Derivative Instruments and Hedging Activities

Statement of Financial Accounting Standards ("SFAS") No. 133, *Accounting for Derivative Instruments and Hedging Activities*, establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial condition and measure those instruments at fair value.

JEFFERIES & COMPANY, INC. AND SUBSIDIARY

Notes to Consolidated Statement of Financial Condition, Continued

December 31, 2001

This statement was amended by both SFAS No. 137 and SFAS No. 138 and is effective for all fiscal quarters of fiscal years beginning after June 15, 2000. On January 1, 2001, the Company implemented this statement without a material impact on the Company.

New Accounting Standard on Transfers and Servicing of Financial Assets and Extinguishments of Liabilities

SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, establishes accounting and reporting standards for transfers and servicing of financial assets and extinguishments of liabilities. Those standards are based on consistent application of a financial-components approach that focuses on control. SFAS No. 140 requires a debtor to (a) reclassify financial assets pledged as collateral and report those assets in its statement of financial condition separately from other assets not so encumbered if the secured party has the right by contract or custom to sell or repledge the collateral and (b) disclose assets pledged as collateral that have not been reclassified and separately reported in the statement of financial condition.

This statement is effective for recognition and reclassification of collateral and for disclosures relating to securitization transactions and collateral for fiscal years ending after December 15, 2000. Disclosures about securitizations and collateral accepted need not be reported for periods on or before December 15, 2000, for which financial statements are presented for comparative purposes. On December 31, 2000, the Company implemented this statement without a material impact on the Company.

New Accounting Standards on Business Combinations and Goodwill and Other Intangible Assets

SFAS No. 141, *Business Combinations*, and SFAS No. 142, *Goodwill and Other Intangible Assets*, changed the accounting for business combinations and goodwill in two significant ways. First, SFAS No. 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. Use of the pooling-of-interests method is now prohibited. Second, SFAS No. 142 changed the accounting for goodwill from an amortization method to an impairment-only approach. Thus, amortization of goodwill, including goodwill recorded in past business combinations, will cease upon adoption of that Statement, which, for companies with calendar year ends, is January 1, 2002. The implementation of these statements did not have a material impact on the Company.

New Accounting Standards on Accounting for Asset Retirement Obligations

SFAS No. 143, *Accounting for Asset Retirement Obligations*, addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. This Statement is effective for financial statements issued for fiscal years beginning after June 15, 2002. The implementation of this statement is not expected to have a material impact on the Company.

JEFFERIES & COMPANY, INC. AND SUBSIDIARY

Notes to Consolidated Statement of Financial Condition, Continued

December 31, 2001

New Accounting Standards on Accounting for the Impairment or Disposal of Long-Lived Assets

SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, addresses financial accounting and reporting for the impairment or disposal of long-lived assets. This Statement supersedes SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*, and the accounting and reporting provisions of APB Opinion No. 30, *Reporting the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*, for the disposal of a segment of a business. This Statement also eliminates the exception to consolidation for a subsidiary for which control is likely to be temporary. The provisions of this Statement are effective for financial statements issued for fiscal years beginning after December 15, 2001 and interim periods within those fiscal years. The provisions of this Statement generally are to be applied prospectively. The implementation of this Statement is not expected to have a material impact on the Company.

Use of Estimates

Management of the Company has made a number of estimates and assumptions relating to the reporting of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported amounts of revenues and expenses to prepare this consolidated statement of financial condition in conformity with generally accepted accounting principles. Actual results could differ from those estimates.

(2) Receivable from, and Payable to, Brokers and Dealers

The following is a summary of the major categories of receivable from, and payable to, brokers and dealers as of December 31, 2001 (in thousands of dollars):

Receivable from brokers and dealers:	
Securities borrowed	\$ 3,886,918
Other	143,751
	<u>4,030,669</u>
Payable to brokers and dealers:	
Securities loaned	\$ 3,838,999
Other	27,777
	<u>3,866,776</u>

The Company has a securities borrowed versus securities loaned business with other brokers. The Company also borrows securities to cover short sales and to complete transactions in which customers have failed to deliver securities by the required settlement date, and lends securities to other brokers and dealers for similar purposes. From these activities, the Company derives interest revenue and interest expense.

JEFFERIES & COMPANY, INC. AND SUBSIDIARY

Notes to Consolidated Statement of Financial Condition, Continued

December 31, 2001

(3) Receivable from Customers, Officers and Directors

The following is a summary of the major categories of receivable from customers, officers and directors as of December 31, 2001 (in thousands of dollars):

Customers (net of allowance for uncollectible accounts of \$6,629)	\$	124,693
Officers and directors		1,702
	\$	126,395

Interest is paid on free credit balances in accounts of customers who have indicated that the funds will be used for investment at a future date. The rate of interest paid on such free credit balances varies between the thirteen-week treasury bill rate and 1% below that rate, depending upon the size of the customers' free credit balances.

(4) Securities Owned, Securities Pledged to Creditors and Securities Sold, Not Yet Purchased

The following is a summary of the market value of major categories of securities owned and securities sold, not yet purchased, as of December 31, 2001 (in thousands of dollars):

		Securities owned	Securities sold, not yet purchased
Corporate equity securities	\$	56,635	69,094
Corporate debt securities		130,296	3,936
Options		705	202
	\$	187,636	73,232

The following is a summary of the market value of major categories of securities pledged to creditors as of December 31, 2001 (in thousands of dollars):

		Securities pledged to creditors
Corporate equity securities	\$	15,960
Corporate debt securities		84,302
	\$	100,262

JEFFERIES & COMPANY, INC. AND SUBSIDIARY

Notes to Consolidated Statement of Financial Condition, Continued

December 31, 2001

(5) Investments

The following is a summary of the major categories of investments as of December 31, 2001 (in thousands of dollars):

Partnership interests	\$	49,180
Debt and equity investments		19,374
Equity and debt interests in affiliates		<u>88,508</u>
	\$	<u>157,062</u>

Included in equity and debt interests in affiliates as of December 31, 2001 is \$55,621,000 relating to the Company's interest in the three high yield funds that the Company manages.

(6) Premises and Equipment

The following is a summary of premises and equipment as of December 31, 2001 (in thousands of dollars):

Furniture, fixtures and equipment	\$	67,400
Leasehold improvements		<u>30,880</u>
Total		98,280
Less accumulated depreciation and amortization		<u>55,560</u>
	\$	<u>42,720</u>

(7) Income Taxes

The Company's operations are included in the consolidated Federal income tax return of Jefferies Group, Inc. Substantially all income tax liabilities are due to Jefferies Group, Inc. The Company accounts for income taxes on a separate-return basis.

Deferred income taxes are provided for temporary differences in reporting certain items, principally deferred compensation, and give rise to the deferred tax asset of \$55,953,000 included in other assets.

There was no valuation allowance for deferred tax assets as of December 31, 2001. Management believes it is more likely than not that the Company will generate sufficient taxable income in the future to realize the deferred tax asset.

JEFFERIES & COMPANY, INC. AND SUBSIDIARY

Notes to Consolidated Statement of Financial Condition, Continued

December 31, 2001

(8) Employee Benefit Plans

Certain employees of the Company are covered by a defined benefit pension plan sponsored by the Parent. The plan is subject to the provisions of the Employee Retirement Income Security Act of 1974. Benefits are based on years of service and the employee's career average pay. Jefferies Group, Inc.'s funding policy is to contribute to the plan at least the minimum amount that can be deducted for Federal income tax purposes.

The following tables set forth the plan's funded status and amounts recognized in the Parent's consolidated statement of financial condition (in thousands of dollars):

Projected benefit obligation for service rendered to date	\$	27,086
Plan assets, at fair market value		19,810
Excess of the projected benefit obligation over plan assets		<u>7,276</u>
Unamortized prior service cost		(125)
Unrecognized net loss		(7,279)
Adjustment to recognize minimum liability		<u>4,002</u>
 Pension liability included in other liabilities	 \$	 <u><u>3,874</u></u>

The following tables reconcile the fair value of assets and the projected benefit obligation of the Parent Company's plan for the year ended December 31, 2001 (in thousands of dollars):

Fair value of assets, beginning of year	\$	19,093
Employer contributions		1,772
Benefit payments made		(824)
Total investment return		<u>(231)</u>
 Fair value of assets, end of year	 \$	 <u><u>19,810</u></u>

Projected benefit obligation, beginning of year	\$	24,208
Service cost		1,251
Interest cost		1,803
Actuarial gains and losses		648
Benefits paid		<u>(824)</u>
 Projected benefit obligation, end of year	 \$	 <u><u>27,086</u></u>

The plan assets consist of approximately 60% equities and 40% fixed income securities.

The weighted average discount rate and the rate of increase in future compensation levels used in determining the actuarial present value of the projected benefit obligation were 7.25% and 5.25%, respectively, in 2001. The expected long-term rate of return on assets was 8.40% in 2001.

JEFFERIES & COMPANY, INC. AND SUBSIDIARY

Notes to Consolidated Statement of Financial Condition, Continued

December 31, 2001

The Company incurs expenses related to various benefit plans of the Parent covering substantially all employees, including an Employee Stock Ownership Plan, an Employee Stock Purchase Plan (ESPP) designed to qualify under Section 423 of the Internal Revenue Code (IRC) and a profit sharing plan, which includes a salary reduction feature designed to qualify under Section 401(k) of the IRC. The Company also participates in a stock ownership and long-term incentive plan (the Plan) sponsored by the Parent. The Plan allows awards to certain employees in the form of incentive stock options, nonqualified stock options, stock appreciation rights, restricted stock, unrestricted stock, performance award dividend equivalents or other stock based awards.

(9) Related Party Transactions

The Company received interest revenues from Jefferies International Limited. The Company paid service fees to Jefferies International Limited and Jefferies Pacific Limited for various broker services.

The Company received clearing fees and administrative service charges from W & D Securities, Inc. The Company paid W & D Securities, Inc. for execution and interest.

The Company received asset management revenues from its three high yield domestic funds.

The Company provides trading, clearing and general and administrative services, which are reimbursed by the three high yield domestic funds.

The Company provides clearing and general and administrative services, which are reimbursed by Bonds Direct Securities LLC.

The Company received placement fees from Jefferies Partners Opportunity Fund, LLC and Jefferies Partners Opportunity Fund II, LLC.

(10) Financial Instruments

Off-Balance Sheet Risk

The Company has contractual commitments arising in the ordinary course of business for securities loaned or purchased under agreements to sell, securities sold but not yet purchased, repurchase agreements, future purchases and sales of foreign currencies, securities transactions on a when-issued basis, options contracts and underwriting. Each of these financial instruments and activities contains varying degrees of off-balance sheet risk whereby the market values of the securities underlying the financial instruments may be in excess of, or less than, the contract amount. The settlement of these transactions is not expected to have a material effect upon the Company's consolidated statement of financial condition.

In the normal course of business, the Company had letters of credit outstanding aggregating \$32,800,000 at December 31, 2001 to satisfy various collateral requirements in lieu of depositing cash or securities.

JEFFERIES & COMPANY, INC. AND SUBSIDIARY

Notes to Consolidated Statement of Financial Condition, Continued

December 31, 2001

The gross contracted or notional amounts of index futures contracts, options contracts and foreign exchange forward contracts, which are not reflected in the consolidated statement of financial condition, are set forth in the table below and provide only a measure of the Company's involvement in these contracts at December 31, 2001. They do not represent amounts subject to market risk and in many cases, serve to reduce the Company's overall exposure to market and other risks:

	<u>Notional or contracted amount</u>	
	<u>Purchase</u>	<u>Sale</u>
	(Dollars in thousands)	
Index futures contracts	\$ —	1,410
Option contracts	9,687	1,765
Foreign exchange forward contracts	6,655	16,121

Credit Risk

In the normal course of business, the Company is involved in the execution, settlement and financing of various customer and principal securities transactions. Customer activities are transacted on a cash, margin or delivery-versus-payment basis. Securities transactions are subject to the risk of counterparty or customer nonperformance. However, transactions are collateralized by the underlying security, thereby reducing the associated risk to changes in the market value of the security through settlement date or to the extent of margin balances.

The Company seeks to control the risk associated with these transactions by establishing and monitoring credit limits and by monitoring collateral and transaction levels daily. The Company may require counterparties to deposit additional collateral or return collateral pledged. In the case of aged securities failed to receive, the Company may, under industry regulations, purchase the underlying securities in the market and seek reimbursement for any losses from the counterparty.

Concentration of Credit Risk

As a major securities firm, the Company's activities are executed primarily with and on behalf of other financial institutions including brokers and dealers, banks and other institutional customers. Concentrations of credit risk can be affected by changes in economic, industry or geographical factors. The Company seeks to control its credit risk and the potential risk concentration through a variety of reporting and control procedures including those described in the preceding discussion of credit risk.

Fair Value of Derivative Financial Instruments

The Company has derivative financial instrument positions in option contracts, foreign exchange forward contracts and index futures contracts, which are measured at fair value with gains and losses recognized in earnings. The option positions taken are generally part of a strategy in which related equity positions are taken. The foreign exchange forward contract positions are generally

JEFFERIES & COMPANY, INC. AND SUBSIDIARY

Notes to Consolidated Statement of Financial Condition, Continued

December 31, 2001

taken to lock in the dollar cost or proceeds of foreign currency commitments associated with unsettled foreign denominated securities purchases or sales. The average maturity of the forward contracts is generally less than a week. The index futures positions are generally taken as a hedge versus securities inventories or other investments.

The following is an aggregate summary of the average 2001 and December 31, 2001 fair values of derivative financial instruments (in thousands of dollars):

	<u>Average</u>	<u>End of year</u>
Index futures contracts:		
In a favorable position	\$ 58	—
In an unfavorable position	34	26
Option contracts:		
Purchases	976	705
Sales	150	202
Foreign exchange forward contracts:		
Purchases	11,520	6,655
Sales	7,478	16,121

(11) Net Capital Requirement

The Company is subject to the Securities and Exchange Commission ("SEC") Uniform Net Capital Rule (Rule 15c3-1), which requires the maintenance of minimum net capital. The Company has elected to use the alternative method permitted by Rule 15c3-1, which requires that the Company maintain minimum net capital, as defined, equal to the greater of \$250,000 or 2% of aggregate debit balances arising from customer transactions, as defined.

At December 31, 2001, the Company had net capital of \$138,172,000, which was 71% of aggregate debit balances and \$134,268,000 in excess of required net capital.

(12) Contingencies

Many aspects of the Company's business involve substantial risks of liability. In the normal course of business, the Company and its subsidiaries have been named as defendants or co-defendants in lawsuits primarily involving claims for damages. The Company's management believes that pending litigation will not have a material adverse effect on the Company.

JEFFERIES & COMPANY, INC. AND SUBSIDIARY

Notes to Consolidated Statement of Financial Condition, Continued

December 31, 2001

(13) Leases

As lessee, the Company leases certain premises and equipment under noncancelable agreements expiring at various dates through 2013. Future minimum lease payments for all noncancelable operating leases at December 31, 2001 are as follows (in thousands of dollars):

	<u>Gross</u>	<u>Sub-leases</u>	<u>Net</u>
2002	\$ 14,776	1,253	13,523
2003	14,400	1,095	13,305
2004	14,266	1,019	13,247
2005	13,768	483	13,285
2006	13,118	—	13,118
Thereafter	41,704	—	41,704