Government of Israel

Essence of Financial Statements

December 31st 2007

(Unaudited)

Table of Contents

	page
Preface to the Financial Statements ……...…….	**3**
Main Changes Compared to the Financial Statements Data of the 2006 Fiscal Year…….	**6**
Statement of Financial Position ……....	**9**
Statement of Changes in Net Assets/Equity …..…….....	**11**
Statement of Budget Execution for 2007:	
Statement of State Budget Execution – Expenses by Government Offices Comptrollerships …….....	**13**
Statement of State Budget Execution – Revenues According to Budgetary Items ……	**16**
Notes to the financial statements for December 31st 2007:	
Note 1 - General ……	**18**
Note 2 - Accounting policy principles ……..	**24**

Preface to the Financial Statements

Recently, governments of leading nations in the western world introduced far-reaching reforms in government accounting procedures intended to provide adequate disclosure and transparency to their monetary activities. The Government of the State of Israel is also in the process of a similar reform in government accounting which mainly involves a transition from cash basis accounting reporting from to an accrual basis accounting reporting. The purpose of this reform is to provide the public and the decision makers, as well as other user of the financial statements, reliable and complete information regarding the financial position of the Government of the State of Israel, according to a principle that transparency is a foundation stone in a proper and efficient administration.

The statements submitted herein are an additional step in the accounting reform led by the Accountant General during the past few years, intended to adopt and gradually implement the International Public Sector Accounting Standards (IPSAS) while maintaining the due diligence principle. Following the Accountant General's decision, the financial statements are published on March 31st every year according to the accepted standards for public companies traded in Israel.

Statement of budget and its execution

The state budget is the government work plan and the government most important document since it includes the details of the government policy and its goals in the most binding form. The budget is the main work tool of the government offices financial activity.

The budget execution data is presented according to the executing comptrollership. This presentation matches the budget scope as approved by the Knesset and accordingly makes it possible to have a follow-up on the budget execution. Furthermore, this presentation matches the standards recommended by the OECD by creating a positive pressure that leads to a better accountability by the executing entities, regarding data for which they are responsible. This presentation makes it possible to have efficient follow-up on the budget that had been approved by the Knesset.

Analysis of the budget execution data presented in the report raises a number of issues, both in building the budget and in its execution. There is a number of procedures that sometimes lead to low-level execution in some of the government offices and that should be attended to:

- Estimates that do not match the extent of the actual execution in some of the budget regulations. However, it should be noted that budget planning is sometimes affected by a large number of uncertainties, such as: price indexes, interest rates, exchange rates, wage agreements, statutory certificates etc.
- Increase in use of the surplus mechanism in projects that are managed as a closed economy. The meaning of a closed economy is that the total project expenses (within the framework of a closed economy) shall not exceed the total revenues that the ministry collects for the project. Usually, the revenues for covering the total planning and development expenses for the project are received upon the beginning of the project while the project expenses are created and paid according to the project's actual progress.
- The budgeting of reserves that are occasionally released according to the need and the required certainty towards the end of a fiscal year. Release of that reserve requires the approval of the Ministry of Finance and the Finance Committee.
- Budget regulations for participation in activities of another government office – reporting about the execution of budget regulations for participation in activities of another government office is sometimes carried out without proper disclosure in the state books regarding the mutual financial settlement between the different offices. Moreover, there are inter-ministerial transfers that are not within the scope of budget regulations for participation in activities of another government office, despite them essentially being such budget regulations. There is a need for administrative work at the Ministry of Finance in regard to this matter in order to solve the problem.

It should be clarified that all reserve and surplus mechanisms are the budgeting methods used in the state budget according to the Budget Bill – 1985.

Budgetary control:

- It was found in a number of government offices that budget entries are not always made according to a homogeneous methodology (such as setting-off expenses in accounting for income etc.).
- It was found that there are changes in the attribution of budget execution throughout the budget year.
- It was found that government offices do not always hold an appropriate documentation of the extent of engagements or the expected cash flow rate (payment scheduling, aging) of the engagements.
- It was fond that at the time of converting the data to the Merkava ERP system, appropriate documentation regarding the financial data has not always been kept, causing problems with the reliability of the data.

Statement of Financial Position

On July 20th 2004, following the Accountant General's initiative, a government decision was issued by the Ministers' Committee for the State Auditing regarding the adoption of the International Public Sector Accounting Standards (IPSAS). The Accountant General is at the midst of a reform in the management of the state assets and liabilities and the government financial reporting, and which main focus, as mentioned earlier, is the transition to reporting on an accrual basis, and the implementation of international standards. A significant part of the data in the statement on financial position is presented in accordance with the standards set by the IPSAS.

It should be noted, however, that the statement of assets presented in the financial statement does not represent all the assets of the State of Israel. It does not yet include a large number of assets the value of which or their cost is very substantial, such as: cost of the infrastructure assets, a substantial part of the state investment in the defense system, all the state real estate, all the heritage assets, some of the overseas assets and most of the intangible assets.
In addition, it should be noted that information regarding the assets and liabilities of the State of Israel is not based on a comprehensive accounting and report system. The bookkeeping systems in a large number of government offices do not support financial information on an accrual basis. The financial information as a whole is unaudited and is based, among other things, on auxiliary systems used in conjunction with the main accounting system as well as on reports received from different entities managing certain assets and liabilities for the government of Israel. The Accountant General does not have full information regarding the quality of the auditing procedures in some of the said entities. Regarding substantial sum balances, discrepancies were found between the Accountant General's auxiliary accounts and the balances in entities where these are handled. These discrepancies will be closed as the Merkava ERP project is progressing and at the same time as the financial auditing is carried out at the government offices.
The database used for preparing the balance data is not a closed system, and therefore, it is impossible to check the completeness of the data which is essential for determining that the report of the financial position reflects all the assets and liabilities of the government of Israel and prepared according to the generally accepted accounting principles (GAAP).

Information on the state guarantees

The Accountant General is authorized to guarantee in the name of the State of Israel, for a loan, for an export business or for any other financial undertaking, if in its opinion, this guarantee could assist in the development or encouragement of an economically important industry or assist in any other purpose that is in the public interest. The guarantee is granted according to the State Guarantees Law – 1958 following a detailed examination of its necessity and contribution to achieving the economic policy objectives and the approval of the Knesset Financial Committee.

External audit on the financial statements data

The financial statements data of the government of Israel for 2007 is unaudited. However, the Accountant General is in the process of gradually introducing external audit of the financial statements of government offices. Accordingly, accountants have been appointed during 2007 for four government offices (the Water Authority, the Ministry of Environmental Protection, the Court Administration and the Ministry of Health) for the purpose of conducting an external audit of the financial statements submitted by these government offices for the 2007 fiscal year. The audit work has not yet been completed as of the date of publishing these financial statements.

Main differences compared to the financial statements data of the 2006 fiscal year

The Accountant General's annual work plan placed an emphasis on taking steps that will lead to significant improvement in the quality of reporting for 2007. Some of the major changes include the following:

1. **Presenting the Statement of Changes in Net Assets / Equity -**
   According to Government Accounting Standard No.1 – "Presentation of Financial Statements" a *Statements of Changes in Net Assets/Equity* is first presented as part of the financial statements for 2007, including breakdown of government capital funds handled by the Accountant General.

2. **Consolidation of the National Insurance financial statements –**
   The National Insurance Institute was established in 1954 in order to provide benefits and social security for residents of the State of Israel according to the National Insurance Law. In the financial statements of 2007, the Government Accounting Standard No. 6 – "Consolidated financial statements and accounting for controlled entities" was initially implemented. According to Standard No. 6, the National Insurance Institute is defined as a "controlled entity" for financial reporting purposes. According to the principles set in Standard No. 6, it is required to exercise discretion based on the definition of "control" in the Standard and the unique circumstances of each case. Therefore, it is required to take into consideration the nature of the relations between the two entities. Specifically, it is required to take into consideration the two components of the definition of "control": the component of power (the power to set the financial and operational policy of another entity) and the benefit component (representing the ability of the controlling entity to benefit from the activities of the other entity).
   The financial statements of the Government of Israel include for the first time consolidated statements with the National Insurance Institute. It should be noted that the financial statements of the National Insurance Institute that are consolidated as aforesaid, have not yet been audited by the external auditors (the comparison figures for 2006 are taken from audited financial statements).

3. **Consolidation of the financial statements of the Internal Fund for Government Insurance -**
   The internal fund for government insurance (managed by Inbal Insurance Company Ltd.) is a non-profit financial fund owned by the government. The money in this fund is held by the Accountant General at the Ministry of Finance, and all of its activities are carried out for the Government of Israel and entities controlled by the Government of Israel. The internal fund covers especially: government property (including vehicles) and the property of entities associated with the government, the liability of government units to the public as holders of buildings and premises, and liability to the public in regard to specific issues related to government offices and entities associated with the government.
   The financial statements of the Internal Fund for Government Insurance have been consolidated for the first time and are presented as part of the financial statements of the Government of Israel for 2007 (including a restatement of the comparative amounts for 2006). It should be noted that the financial statements of the Internal Fund for Government Insurance have not yet been audited by external auditors.

4. **Consolidation of the financial statements of health-related corporations affiliated with the general state hospitals –**
   Health-related corporations – medical research funds, infrastructure development and health services affiliated with the hospitals, operate within the general government hospitals. Health corporations constitute an independent legal entity operating in accordance with the Budget Bill Regulations (principles of health corporations activities) – 2001, published by the Minister of Health on December 4th 2001 following consultation with the Minister of Finance and the Civil Service Commissioner. The regulations deal, among other things, with the organizational

structure of corporations, auditing principles, the corporations' activity, the corporations' investment in the hospital, the corporations' payment to the hospital, engagement execution procedures, the corporations' activity outside the hospital, service rates, budget, restrictions in the assumption of loans, reporting requirements, work and wage conditions and discipline provisions. Government Accounting Standard No. 6 - "Consolidated financial statements and accounting for controlled entities" was implemented in the financial statements of 2007. According to the Standard, health corporations were defined as "controlled entities" for the purpose of financial reporting, and were therefore presented for the first time this year as part of the financial statements of the Government of Israel (comparative amounts for 2006 have not been restated). It should be noted that the financial statements of health corporations have not yet been audited by external auditors.

5. **Presentation of the investment in bi-national funds –**
The Government of Israel, in collaboration with a number of foreign governments, established in the 1980s bi-national funds for the purpose of promoting common interests, such as: agricultural research, industrial research and the advancement of education. The investment data of the government of Israel in the bi-national funds are presented in the financial statements of 2007 on the equity basis according to Government Accounting Standard No. 7 "Accounting for investments in associates".

6. **Report regarding Public Private Partnerships (PPP)**
The statement of financial position for the year 2007 includes disclosure regarding the government investments and liabilities for to projects led by the Accountant General in collaboration with the private sector (PPP), including the Highway No. 6 project, desalination plants and more.

7. **Significant expansion of the reporting for fixed assets –**
The financial statements of 2007 present for the first time infrastructure assets, structures, equipment and projects as specified below:
   - The inter-city road system at the length of 4,895 km spread on 140,000 dunam of land (excluding the Ayalon highway and Road No. 6 – which is included in the report on projects in collaboration with the private sector).
   - Partial data regarding structures and security equipment, including: aircraft, sea-craft, tanks, part of the residential assets and the Ministry of Defense investments in assets overseas.
   - Central information systems projects.

8. **Significant expansion of reporting for inventory –**
The financial statements of 2007 includes for the first time data about the inventory of the defense system and the Government Printer, as well as additional data regarding the non-term inventory intended for emergency use.

9. **Inclusion of provision and contingent liability for lawsuits against the State –**
Following mapping work conducted in 2007 at the government offices, adequate disclosure was given in the financial statements, which includes among other things, information regarding accounting provisions as well as information regarding contingent liabilities for lawsuits filed against different government offices. The disclosure includes provision for anticipated costs of professional liability of the government medical institutions and the district health offices, based upon actuarial work conducted in regard to this matter.

10. **Expansion of reporting regarding the State guarantees –**
The financial reports of 2007 include extensive information regarding the state's exposure and the impact that could be caused due to anticipated realizations of guarantees given by the state.

11. Inclusion of the data of debts due to taxes –

The financial statements of 2007 present for the first time the data regarding the debts to the Tax Authority, including: income tax debts, betterment tax debts, sale tax debts, acquisition tax debts, VAT debts, purchase tax debts, deductions debts, property tax debts and contractors' debts. A differentiation was made in accordance with the generally accepted accounting principles (GAAP), and adequate disclosure was given to debts meeting the asset recognition principles, and debts constituting a "contingent asset" as defined in Government Accounting Standard No. 19 – "Provisions, contingent liabilities and contingent assets".

12. Provision for doubtful debts due to State loans –

The financial statements of 2007 include for the first time a general provision for doubtful debts due to State loans, as well as a specific provision due to loans for housing, according to the reports of the banks operating in accordance with the Supervisor of Banks.

Statement of Financial Position

(in millions of NIS)

	Consolidated (*) December 31st		Government of Israel December 31st	
	2007	**2006**	**2007**	**2006 (**)**
Current Assets:				
Cash and Cash Equivalents	9,964	9,005	9,849	8,916
Deposits in Banks and Institutions	972	978	854	862
AR from Current Loans and Current Maturities	7,163	6,121	7,163	6,121
Other AR	29,257	9,562	24,225	4,882
Inventory	327	181	327	181
	47,683	**25,847**	**42,418**	**20,962**
Long-term Investments, Loans and Account Receivables:				
Long-term Loans and Other Investments	47,333	51,410	47,333	51,410
Investments in Associated Companies and Other Entities	62,533	60,845	62,533	60,845
Investment in Administrative Property	3,613	4,003	3,613	4,003
Other investments and AR	201	309	201	309
Long-term Inventory	947	957	947	957
	114,627	**117,524**	**114,627**	**117,524**
Investment in Public Private Partnerships	**6,663**	**6,361**	**6,663**	**6,361**
Fixed Assets	**150,308**	**10,084**	**149,425**	**9,201**
Other Assets	**169**	**128**	**169**	**128**
	319,450	**159,944**	**313,302**	**154,176**

(*) Consolidated data of the Government of Israel and the National Insurance Institute
(**) Restated

The assets represented in the report do not represent the overall assets of the State of Israel, but a small part of them.
The assets presented in the report do not yet include a large number of assets which value or cost is very substantial, such as: infrastructure assets, the State investments in the defense system, all the State real estate assets, all the heritage assets, some of the assets overseas and most of the intangible assets.

Statement of financial position
(in millions of NIS)

	Consolidated (*) December 31st		Government of Israel December 31st	
	2007	**2006**	**2007**	**2006(**)**
Current liabilities:				
Short-term credit	5,330	2,070	5,330	2,070
Internal loans – Current maturities	48,197	50,232	56,191	57,875
External loans – Current maturities	36,175	19,374	36,175	19,374
AP due to deposits and collateral	1,933	3,130	1,933	3,130
Other AP and credit balances	19,836	18,821	15,846	15,115
	111,471	**93,627**	**115,475**	**97,564**
Long-term liabilities:				
Internal loans – after deducting current maturities	360,522	357,161	473,429	459,675
External loans – after deducting current maturities	83,829	116,963	83,829	116,963
Liabilities due to losses of affiliated entities	3,950	3,180	3,950	3,180
Obligation to support pension funds	89,722	87,453	89,722	87,453
Liabilities due to employees' rights	393,346	369,383	390,876	367,001
Reserves due to insurance events	226,477	214,586	130	108
Provision for lawsuits	3,400	22	3,400	16
Other long-term liabilities	2,528	2,247	2,528	2,247
	1,163,774	**1,150,995**	**1,047,864**	**1,036,643**
Liabilities for Public Private Partnerships	**8,134**	**7,835**	**8,134**	**7,835**
Net assets / Equity	**(963,929)**	**(1,092,513)**	**(858,171)**	**(987,866)**
	319,450	**159,944**	**313,302**	**154,176**

(*) Consolidated data of the Government of Israel and the National Insurance Institute
(**) Restated

The deficit in equity is a residual number that does not represent the accumulated government deficit, since the status of assets presented in the financial statements is incomplete. In regard to this matter, we are bringing to attention the said in the preface to the financial statements and the notes to it.

Monday, March 31st 2008		
Date of approving the financial statements	Shuki Oren Accountant General	Yossi Izkovich, CPA Chief Accountant

The notes to the financial statements form an integral part of the financial statements.

Statements of Changes in Net Assets / Equity
(in millions of NIS)

Consolidated (*)

	Balance on Dec. 31st 2006	Changes in Net Assets (**)	Surplus/ (Deficit) (***)	**Balance on Dec. 31st 2007**
Accumulated surplus / (deficit)	**(1,106,250)**	**128,922**		**(977,328)**
Government capital reserves – non-budget				
USA guarantee fund	11,778	-	(413)	11,365
Commissions fund (loss coverage)	957	-	29	986
Compensation fund (property tax)	-	-	7	7
Internal fund for government insurance	773	-	44	817
The administrator of absentees property	19	-	1	20
Fixed assets renewal fund	6	-	(6)	-
Total capital non-budget reserves	**13,533**	**-**	**(338)**	**13,195**
The National Insurance Institute capital reserve	**204**	**-**	**-**	**204**
Government capital funds – Budgetary	**-**	**-**	**-**	**-**
Total net assets	**(1,092,513)**	**128,922**	**(338)**	**(963,929)**

(*) Consolidated data of the Government of Israel and the National Insurance Institute

(**) Including cumulative effect for the beginning of the year as result of asset recognition, the change in the accounting method and the current surplus/deficit

(***) Due to capital funds only.

The deficit in equity is a residual number that does not represent the accumulated government deficit, since the status of assets presented in the financial statements is incomplete. In regard to this matter, we are bringing to attention the said in the preface to the financial statements and the notes to it.

The notes to the financial statements form an integral part of the financial statements.

Statements of Changes in Net Assets / Equity
(in millions of NIS)

Government of Israel

	Balance on Dec. 31st 2006	Changes in Net Assets (**)	Surplus/ (Deficit) (***)	**Balance on Dec. 31st 2007**
Accumulated surplus / (deficit)	**(1,001,399)**	**130,033**	**-**	**(871,366)**
Government capital reserves – non-budget				
USA guarantee fund	11,778	-	(413)	11,365
Commissions fund (loss coverage)	957	-	29	986
Compensation fund (property tax)	-	-	7	7
Internal fund for government insurance	773	-	44	817
The administrator of absentees property	19	-	1	20
Fixed assets renewal fund	6	-	(6)	-
Total capital non-budget reserve	**13,533**	**-**	**(338)**	**13,195**
Government capital funds – Budgetary	**-**	**-**	**-**	**-**
Total net assets	**(987,866)**	**130,033**	**(338)**	**(858,171)**

(*) Including cumulative effect for the beginning of the year as result of asset recognition, the change in the accounting method and the current surplus/deficit

(**) Due to capital funds only.

The deficit in equity is a residual number that does not represent the accumulated government deficit, since the status of assets presented in the financial statements is incomplete. In regard to this matter, we are bringing to attention the said in the preface to the financial statements and the notes to it.

The notes to the financial statements form an integral part of the financial statements.

Statements of Budget Performance

Statement of State Budget Performance (gross) for 2007 – Expenses according to the government offices comptrollership (millions of NIS)

Office Name	Budget		Performance		Remainder		Performance Percentage	
	Gross	Designated Income	Gross	Designated Income	Gross	Designated Income	Gross	Designated Income
Accountant General	122,556	(157)	127,763	(37)	(5,207)	(120)	104%	23%
Ministry of Defense	59,981	(2,608)	55,849	(2,747)	4,132	139	93%	105%
Ministry of Education	33,848	(1,352)	31,698	(1,194)	2,151	(159)	94%	88%
Ministry of Health	17,693	(2,398)	17,175	(2,371)	518	(27)	97%	99%
Ministry of Transportation	10,682	(209)	9,440	(140)	1,243	(69)	88%	67%
Ministry of Construction and Housing	6,981	(882)	5,314	(738)	1,667	(144)	76%	84%
Retirement Administration	8,364	(393)	8,270	(412)	94	19	99%	105%
Israel Police	7,165	(436)	6,978	(302)	187	(134)	97%	69%
Ministry of Interior	5,736	(56)	4,597	(21)	1,139	(35)	80%	37%
Ministry of Industry, Trade and Labor	5,136	(581)	3,814	(535)	1,323	(46)	74%	92%
Ministry of Social Affairs and Social Services	4,892	(1,316)	4,466	(1,199)	426	(117)	91%	91%
Prime Minister's Office	2,895	(24)	1,626	(12)	1,269	(12)	56%	50%
Administration for Rural Education	2,273	(188)	2,099	(149)	175	(39)	92%	79%
Israel Prison Service	1,998	(144)	1,853	(136)	145	(8.2)	93%	94%
Tax Authority	1,690	(216)	1,423	(199)	266	(16)	84%	92%
Ministry of Immigrant Absorption	1,519	(35)	1,196	(7.2)	322	(28)	79%	21%
Handicapped Rehabilitation Bureau	1,654	(1.8)	1,583	(0.5)	71	(1.3)	96%	26%
Ministry of Foreign Affairs	1,556	(56)	1,385	(2.9)	171	(53)	89%	5%
Court Administration	1,449	(111)	1,228	(101)	221	(10)	85%	91%
Water Authority	1,927	(443)	1,117	(0.5)	810	(443)	58%	0%
Ministry of Justice	1,488	(466)	920	(278)	569	(188)	62%	60%
Ministry of Agriculture	1,315	(112)	927	(105)	388	(6.3)	70%	94%
Independent Education Center	956	-	884	-	72	-	93%	***
Israel Knesset	617	(2.2)	535	(0.1)	82	(2.1)	87%	5%
Ministry of Tourism	630	(8.7)	367	(4.6)	263	(4.1)	58%	53%
Ministry of Environmental Protection	649	(57)	276	(40)	373	(17)	42%	70%
Ministry of Finance	762	(200)	565	(183)	197	(17)	74%	91%
Ministry of National Infrastructures	555	(11)	315	(6.5)	240	(4.5)	57%	59%
National Authority for Religious Services	426	-	286	-	139	-	67%	***
The State Comptroller and Ombudsman	311	-	202	-	109	-	65%	***
Agricultural Research Administration	282	(91)	238	(77)	44	(14)	84%	85%
Religious Education	289	(2.2)	257	1.0	32	(3.2)	89%	-44%

Government of Israel – Essence of Financial Statements – December 31st 2007

Office Name	Budget		Performance		Remainder		Performance Percentage	
	Gross	Designated Income	Gross	Designated Income	Gross	Designated Income	Gross	Designated Income
Ministry of Public Security	295	(3.7)	204	(1.1)	90	(2.7)	69%	28%
Central Election Committee	35	-	7.1	-	28	-	20%	***
Coordination of Government Activities In the Territories	189	(54)	130	(41)	59	(13)	69%	77%
Employment Service	171	(6.6)	148	(4.5)	23	(2.1)	87%	69%
Ministry of Science, Culture and Sport	934	(21)	802	(14)	131	(6.3)	86%	69%
Central Bureau of Statistics	189	(11)	142	(4.9)	47	(6.2)	75%	44%
Settlement Division	281	(96)	133	(63)	148	(33)	47%	65%
Educational Television	233	(31)	205	(13)	28	(18)	88%	41%
Government Housing Administration	343	(295)	139	(239)	205	(56)	40%	81%
Israel Mapping Center	139	(24)	76	(13)	63	(11)	55%	54%
Computerized Processing Service	114	(14)	111	(14)	3.1	-	97%	100%
Rabbinical Courts	129	(0.6)	113	(0.3)	15	(0.2)	88%	59%
Government Vehicle Administration	89	(62)	4.4	(30)	84	(32)	5%	48%
Ministry of Communication	64	(0.6)	50	(0.4)	14	(0.2)	77%	65%
President's Office	31	(0.6)	25	(0.2)	6.3	(0.4)	80%	29%
Public Works Department	9.0	-	8.0	-	1.0	-	89%	***
Public Utilities Authority Electricity	13	-	10	-	2.7	-	79%	***
Total	**311,532**	**(13,177)**	**296,954**	**(11,436)**	**14,578**	**(1,741)**	**95%**	**87%**
Business Enterprises								
General Government Hospitals	5,971	(5,971)	5,963	(5,963)	8.6	(8.6)	100%	100%
Israel Land Administration	3,600	(3,600)	4,021	(4,021)	(421)	421	112%	112%
Governmental Advertising Agency	275	(275)	238	(238)	38	(38)	86%	86%
Government Printer	64	(64)	43	(44)	21	(21)	68%	68%
Hadera Port	25	(25)	21	(21)	4.3	(4.3)	83%	83%
Jaffa Port	1.9	(1.9)	1.5	(1.5)	0.4	(0.4)	78%	78%
Total Business Enterprises	**9,938**	**(9,938)**	**10,287**	**(10,278)**	**(349)**	**349**	**104%**	**104%**
Total including business enterprises	**321,470**	**(23,114)**	**307,241**	**(21,722)**	**14,229**	**(1,392)**	**96%**	**94%**

Analysis of State budget and performance according to expense categories

Category	Budget		Performance		Difference		Performance Percentage	
	Gross	Designated Income	Gross	Designated Income	Gross	Designated Income	Gross	Designated Income
Current budgets	201,088	(11,685)	185,234	(10,339)	15,854	(1,346)	92%	88%
Development budgets	14,300	(1,492)	9,780	(1,097)	4,520	(395)	68%	74%
Credit	2,363	-	2,114	-	249	-	89%	***
Principal settling	59,446	-	65,350	-	(5,904)	-	110%	***
Interest and commission payment	34,335	-	34,476	-	(141)	-	100%	***
Total	**311,532**	**(13,177)**	**296,954**	**(11,436)**	**14,578**	**(1,741)**	**95%**	**87%**
Business enterprises	9,938	(9,938)	10,287	(10,287)	(349)	349	104%	104%
Total including business enterprises	**321,470**	**(23,114)**	**307,241**	**(21,722)**	**14,229**	**(1,392)**	**96%**	**94%**

Report of State budget performance for 2007 – Revenues according to Budgetary Items
(Millions of NIS)

Details	Note	Budget	Performance	Difference	Performance Percentage
Current receipts	(1)	185,100	198,262	13,162	107%
Receipts from loans and capital account	(2)	97,764	85,850	(11,914)	88%
Total		**282,864**	**284,112**	**1,248**	**100%**

(1) Current Receipts

Budget Item	Details	Approved budget	Budget Execution	Difference	Percent Executed
01	Income Tax	83,950	91,300	7,350	109%
02	Taxes on salary expenses	8,100	7,933	(167)	98%
03	Betterment tax	1,500	2,398	898	160%
04	Property purchase tax	3,500	2,878	(622)	82%
05	Property tax	100	66	(34)	66%
06	Sale tax	-	421	421	***
07	Employers tax	1,950	1,486	(464)	76%
	Income and property taxes	**99,100**	**106,484**	**7,384**	**107%**
11	Customs and import levies	2,200	2,221	21	101%
13	Purchase tax	12,100	13,587	1,487	112%
14	Net VAT receipts	50,856	53,797	2,941	106%
15	Tobacco tax	700	733	33	105%
18	Fuel tax	10,900	10,590	(310)	97%
20	Stamp tax	-	67	67	***
25	Fees, fines and licenses	4,900	4,611	(289)	94%
	Taxes on expenditure	**81,656**	**85,606**	**3,950**	**105%**
34	Interest in foreign currency	150	163	13	108%
35	Interest collection	2,426	2,284	(142)	94%
41	Interest from the Bank of Israel	-	56	56	***
	Interest and profits	**2,576**	**2,503**	**(73)**	**97%**
42	Royalties from business enterprises	-	2.4	2.4	***
43	Royalties from natural resources	189	217	28	115%
44	Royalties from government. companies	120	110	(10)	92%
45	Dividends from government companies	320	1,005	685	314%
	Royalties and dividends	**629**	**1,335**	**706**	**212%**
46	Reimbursement on account of previous years	28	146	118	521%
47	Miscellaneous revenues	850	1,811	961	213%
48	Earmarked revenues in excess of estimate	56	173	117	309%
50	Government asset usage fees	205	205	-	100%
	Miscellaneous receipts	**1,139**	**2,335**	**1,196**	**205%**
Total	**Current receipts**	**185,100**	**198,262**	**13,162**	**107%**

(2) Receipts from Loans and Capital Accounts

Budget item	Details	Approved Budget	Budget Execution	Difference	Percent Executed
51	Collection of principal	5,483	5,627	144	103%
53	Collection of principal in foreign currency	-	0.7	0.7	***
63	Revenues from Israel Land Administration	532	1,517	985	285%
	Repayment of investments and loans	**6,015**	**7,144**	**1,129**	**119%**
71	Provisions for pensions – economic units	-	0.0	0.0	***
72	Provisions for pensions – business enterprises	11	9.1	(1.4)	87%
73	Provisions for pensions – companies	14	191	177	1345%
	Provisions for pensions and severance pay	**25**	**200**	**175**	**810%**
75	Capital revenues	4,500	6,268	1,768	139%
	Capital revenues	**4,500**	**6,268**	**1,768**	**139%**
81	Loan from the National Insurance Institute	12,084	14,250	2,166	118%
82	Revenue from emissions and deposits	-	6.0	6.0	***
83	Domestic loans	53,625	42,908	(10,717)	80%
	Loans in Israel	**65,709**	**57,164**	**(8,545)**	**87%**
84	Foreign loans	10,551	4,688	(5,863)	44%
90	Grants from abroad	10,964	10,386	(579)	95%
	Loans and grants from abroad	**21,515**	**15,074**	**(6,442)**	**70%**
Total	**Proceeds from loans and capital accounts**	**97,764**	**85,850**	**(11,914)**	**88%**

Notes to the Financial Statements as at December 31st 2007

Note 1 – General:

a) The financial information of the Israeli government as of December 31, 2007 (the "Report") is submitted in accordance with Section 12 of the State Comptroller Law, 5718-1958 [Consolidated Version] and in accordance with Section 49A of the Foundations of the Budget Law, 5745-1985.

b) **Government of Israel** – general description of the main government ministries and authorities through which the government operates is listed below (in descending order according to the volume of executed budget):

(1) Accountant General

The Accountant General Unit is a headquarters unit within the Ministry of finance. It is responsible for unique areas with major impact on the government activity. The Accountant General is responsible for the following main areas:

- Execution of the state budget, signing contracts and engagements by the state, internal audit within the government regarding finance, assets and engagements, financing the deficit and management of the national debt, inter-ministerial tender committees, government accounting, central government procurement, government vehicles, IT systems in government ministries, management of various tenders, management of public private partnerships – PPP, various economic examinations for entities within the government.
- Direct responsibility for the execution of several laws and provisions: the Law of State Assets, Law of Internal Audit (Section 2c), Law of Budget Basics, Law of State Loans, Law of State Guarantees and the Law of Foreign Trade Guarantees, Mandatory Tenders Law, Law of Civil Service (pensions) and the State administrative directives on regulation, finances and property.

(2) Ministry of Defense

The defense system in the State of Israel includes three organizational foundations:

- State level – Minister of Defense is in charge of the defense system. Aides, consultants and administrative units assist him in leading and operating the system.
- Military system – Israeli Defense Army (IDF). The military system is headed by IDF's headquarters (Matkal) under the Chief of Staff, who is the supreme command level of the army.
- Civilian system – Ministry of Defense, support units and corporations (government companies upon which the Minister of Defense is in charge, such as: Israel Aviation Industry, Israel Military Industry).

The Ministry of Defense deals mainly with the following areas: acquisitions for the IDF, management and control of the defense budget, rehabilitation of IDF disabled persons, research and development activity, assistance to bereaved families, defense export, national infrastructure related to the defense system etc.

(3) Ministry of Education

The Ministry of Education is responsible for the educational system, including kindergartens, schools, higher education and informal education. The ministry's activity is focused on legislation and the planning of educational services, licensing of professionals in the filed of education and teaching, and inspection on educational institutions.
The Ministry is responsible for the execution of several major laws, including: Compulsory Education Law – 1949, State Education Law – 1953, Council for Higher Education Law – 1948, Special Education Law – 1988, Public Libraries Law – 1975, and more.
The main objectives of the ministry include: implementation of the recommendations of the National Task Force for the Advancement of Education in Israel, narrowing the gaps and promotion of learning achievements, cultivation of values and the teaching of national heritage, promotion of science and technology education, reinforcement and improvement of teaching personnel, and more.

(4) Ministry of Health

The Ministry of Health is in charge of health services in the State of Israel in aspects of setting the overall policy, inspection, licensing, and coordination of the system and setting standards. The Ministry directly operates approximately half of the hospitalization beds of various types, and most of the personal services system within the framework of family health centers. The main tasks of the ministry are:

- Planning, inspection and control, licensing and registration of the health services work in Israel, licensing of medical professionals, preparation of master plans for applied medical research, training of nursing personnel for work in medical institutions, and organization and preparation of the health system for emergency situations.
- Securing general hospitalization services as well as psychiatric, rehabilitation and nursing services, securing preventive medicine services, inspection and control of health funds as required by the State Health Insurance Law – 1994, and inspection of the production of food for local consumption and export.

(5) Ministry of Transportation

The Ministry is responsible for air, sea and land transportation policy in the State of Israel. The Ministry is also responsible for public transportation, development of urban and inter-urban roads, development of train and ports infrastructures, and activities intended to improve road safety. The Ministry of Transportation includes the activities of the National Authority for Road Safety.

In regard of the land transportation, the Ministry is responsible for the licensing of vehicles and drivers, inspection of public transportation services, planning and investing in roads and trains infrastructure. Within the framework of air transportation, the ministry is responsible for international and inland aviation services, inspection of the Airports Authority and Israeli airlines, inspection of flight safety and licensing for flight professionals and aircraft. The ministry inspects the sea transportation through the Ports Authority, and is in charge of Israeli shipping companies and sea-craft.

(6) Retirement Administration

The main task of the Retirement Administration at the Ministry of Finance is the payment of pension to civil service employees insured by budgetary pensions under the Civil Service Law (Pensions) – 1970. The Administration pays the pension to government employees under budgetary pension, excluding employees of the Ministry of Defense, Israel Police, Israel Prison Service, General Security Services, the Mossad, and employees of the supporting units associated with the Ministry of Defense.

(7) Israel Police

Israel police operates in accordance with the authority granted to every police officer under the Police Ordinance (new version) – 1971 as well as additional legislation. Police force is responsible for law enforcement and maintenance of public order in the country. Police is responsible for internal security intended to prevent terrorist bombings. Police force carries out various activities intended to maintain public order, activities intended to prevent criminal offenses, and operates traffic police.

(8) Ministry of Construction and Housing

The Ministry of Construction and Housing is responsible for construction and housing in Israel. The Ministry deals with the creation of infrastructure and in construction as well providing public housing solutions and subsidizing mortgages for apartment acquisitions. The ministry encourages residential construction, enforcement of construction standards, reconstruction of older neighborhoods and urban renewal.

(9) Ministry of the Interior

The Ministry of the Interior operates on both national and district levels. The Ministry is in charge of the following main areas: administration and registration of the population, local government administration, supervision of elections at local authorities, planning and construction administration in Israel, firefighting and rescue commission, water commission which is in charge of reconstruction and development of the water system at local authorities and water and sewage corporations, inspection of bathing sites, licensing of fire arms and more.

(10) Ministry of Industry, Trade and Employment

This ministry is an economic ministry which main purpose is to encourage Israel's economic growth, utilization of the human capital and its improvement, inspection of domestic and foreign trade, and handling employment matters. For the purpose of achieving its goals, the Ministry operates a number of major forms of assistance: granting benefits under the Capital Investment Encouragement Law – 1990 and the Industry Research and Development – 1984, investments in the development of industrial areas, support and encouragement of export, assistance to small and medium size businesses, advancement and development of human capital, and more.

(11) Prime Minister Office

Prime Minister Office in Israel is the government office responsible for coordinating the activities of government offices in various areas, and assisting the Prime Minister of Israel on his daily agenda. The Office is responsible for formation of government policy, conducting cabinet meetings, supervision on the execution of government policy. The Office is also in charge of government entities directly under Prime Minister Office's responsibility.

(12) Tax Authority

The Tax Authority was established on September 1st 2004 following government decision to unify tax collection entities. Income Tax and Land Taxation Department (also known as "Income Tax Commission"), Customs, VAT and IT (computerization branch of the Income Tax Dept.) were unified under the Tax Authority. The main task of the Tax Authority is the collection of taxes and the enforcement of import and export laws in the State of Israel.

(13) Ministry of Justice

The Ministry is in charge of various areas, including legal consultation and legislation, state advocacy, civil legal aid, public defense, administrator general and official receiver dept., land registration dept., government appraiser general dept., authority for the prohibition of money laundering, national center for mediation , Druze and Shariya courts and foreign workers custody courts.

The Ministry also handles the activities of various registrars: registrar of companies, registrar of patents, trade marks, registrar of databases, registrar of approving entities, registrar of fellowship societies, as well as other registrars. In addition, the Ministry is also responsible for the activity of professional registration units: the council of accountants, the council of land appraisers, the council of middlemen and the department for the licensing of notaries, private investigators and guard services.

(14) Courts Administration

Courts Administration is an independent support unit of the Ministry of Justice. It is responsible for providing management services for several units of the legislative branch: the Supreme Court in Jerusalem (also serving as the High Court of Justice), district courts, magistrate courts, labor courts etc. The Ministry is also responsible for activities of the center for the collection of fines, fees and expenses. It handles the collection of fines and debts for government offices and for Authority for Business Limitations.

(15) Ministry of Science, Culture and Sports

The Ministry of Science is in charge of setting the policy for scientific research, infrastructure for scientific foreign relations, distribution of science within the community, development of science in peripheral zones (regional research and development) and the Israeli space agency.

The Ministry handles the work of the National Council for Research and Development, provides assistance to research institutions in the infrastructure field, deals with foreign relations in the scientific field, develops activities that bring science closer to the community, and operates the space research agency as well as research programs that can be applied to industry. In addition, the Ministry is responsible for culture and sports areas (that had been under the Ministry of Education in the past), provides assistance to artists and institutions, and acts towards the cultivation of various sports in Israel at all levels.

(16) Ministry of Finance

The Ministry of Finance is the government's main economic ministry. The Ministry is responsible for planning the economic policy, which includes the preparation of the state budget proposal, inspection and execution of the

approved budget, management of the state revenues, collection of direct and indirect taxes, promotion of investments outside Israel and supervision of the capital market, savings and insurance.
The Ministry handles many tasks related to Israel's economy. It is in contact with the Knesset and its committees on economic matters, budgeting and economic legislation. It is also in ongoing contact with economic entities in Israel and overseas regarding issues related to the state economy as well as management and supervision within the capital market department. The Ministry's activity includes management of the bureau for personal compensation handling the claims of Israeli citizens eligible for health compensation (under the German Compensation Law) from the Government of Germany.

(17) The Ministry of Environmental Protection

The Ministry of Environmental Protection is responsible for initiation and execution of the government policy on environmental quality issues. The ministry's main activity includes phrasing of integrated and comprehensive national policy, development of strategies, standards and priorities for environmental protection and encouragement of educated use of environmental resources. The Ministry is also responsible for the implementation of national-environmental policy, involvement in physical planning processes, guidance of local authorities regarding their environmental responsibility, supervision and enforcement of the environmental laws at local authorities, phrasing of environmental requirements and stipulations in business licensing, accompanying and direction of environmental units and more.

(18) Ministry of Tourism

The Ministry of Tourism is an economic ministry. One of its main objectives is to increase the economic activity in Israel. The Ministry handles the development of public tourism infrastructures through a national development company and through regional development companies. The Ministry is in charge of the planning, development and marketing policy of the tourism industry. The Ministry provides assistance in the establishment of business tourist entrepreneurships throughout the country by providing grants under the capital Investments Encouragement Law – 1990 and in accordance with the investments center procedures.
Main goals and objectives of the Ministry are as follows:

- Planning, development and preservation of tourist infrastructures on the basis of region and matter, marketing of Israel to incoming tourism, for selected audiences and countries overseas, increasing the volume of domestic tourism.
- Training professional personnel in the tourism industry, encouragement of new investments in the tourism industry, development of rural tourism in Israel and promotion of a permanent solution for the protection of the Dead Sea shore.

(19) The Israeli Parliament (the Knesset)

The Knesset is the parliament of the State of Israel. It is the judicial branch of the state. The Knesset has three additional roles: supervision of the government work, election of the president and the state comptroller, and deliberations on state matters through Knesset Committees and plenum work.
There are 12 permanent committees in the Knesset dealing with matters such as finance, security, constitution law and justice, and more. These committees deliberate on drafts, regulations set by the government, proposals for the daily agenda and requests submitted to the Knesset and government by residents.

(20) Ministry of National Infrastructures

The Ministry of National Infrastructures is in charge of the planning and execution of national policy in the field of energy and natural resources infrastructure in Israel.
The government activity is manifested in planning the development of the energy field, setting policy and its implementation in the Israeli economy, arranging the structure of various areas within the Israeli energy economy, supervision of the fuel and electricity economies, arranging the search for oil and gas, making the use of energy more efficient, developing alternative energy sources and organizing the energy economy for emergencies. There are also comprehensive studies conducted through the Ministry in the field of earth studies while developing infrastructures of technological, scientific and economic information intended to be used by all sectors of the economy.

(21) Office of the State Comptroller

This Office is responsible for external audit of various public entities. The Sate Comptroller examines adherence to laws, saving in expenditure and efficiency and integrity of government ministries and state institutions, defense system and local authorities. The Office has a separate unit subject to the Pubic Complaints Commissioner which is responsible to protect citizens from being hurt by government authorities.

(22) Office of Internal Security

The Office of Internal Security is responsible mainly for the security of citizens, maintaining public order, law enforcement and internal security matters in the State of Israel. The Office holds two executive branches: Israel Police and Israel Prison Service. The Office operates projects such as: Matzila Project for the prevention of violence among adolescents that operates in collaboration with local authorities and the City without Violence Project. The Office employs external consultants for the project of electronic supervision of inmates, the privatization of prisons and the electronic enforcement project which includes placement of cameras on roads.

The Office provides support for various entities for the advancement of security in various areas. The Office supports the activities of local authorities intended to prevent violence among adolescents and entities dealing with rescue activities, rehabilitation activities, assistance to children and wives of inmates, assistance to women victims of sexual abuse, and more.

(23) Ministry of Communications

The Ministry of Communications handles regulation of the communications market, including regulation and supervision of the following main areas: domestic telephony, portable radio telephone, international telephony and internet. The Ministry is also responsible for managing of the electromagnetic spectrum in Israel, supervision and management of the council for cable and satellite broadcasting, supervision on Israel Post, and more.

C. **The Institute of National Insurance Institute –** A general description of the Institute of National Insurance and its roles:

The Institute of National Insurance was established in 1954. Its activity is under the National Insurance Institute (integrated version) Law – 1995. Its mission is to provide social benefits and insurance for the residents of the State of Israel. The activity of the National Insurance Institute is extensive and varied. It includes insurance programs for old age and kinsman, mothers, children, work-related injuries, general disability, nursing care, unemployment, bankruptcy, corporate dissolution and more. Apart from cash pensions, the National Insurance Institute provides rehabilitation services and professional training for disabled persons, widows and victims of terrorist attacks, nursing services and counseling services for the elderly. The National Insurance Institute is also in charge of the execution of other laws and agreements in the field of social security, such as Income Insurance Law – 1980. In addition, the Institute collects health insurance fees and is in charge of the distribution of money between health funds and of ongoing management of the list of persons insured by health insurance. The main financing sources of the Institute are: national insurance fees collected from the citizens, allocation of the Ministry of Finance under the national Insurance law, financing of laws and agreements by the Ministry of Finance, and interest on various investments.

D. **Government companies –** General information is given below regarding privatizations that had been executed through the Government Companies Authority and the Accountant General:

In the past few years, extensive privatization is being carried out of government companies operating in various areas including communication, energy, seamanship and aviation. In addition, commercial banks centralizing the major financial activity in Israel are privatized as well.

The privatization of these entities is intended to promote state objectives such as having competition in monopolistic entities while carrying out structural changes and decreasing government involvement in areas that are not part of the core activity of the central government, and to improve the use of public resources. In addition, privatization creates a potential for implementing processes of professionalism and efficiency within the privatized companies, thus leading

to increased ability to compete and profitability levels. The abovementioned developments are beneficial for the companies as well as the entire economy.
The privatization receipts are a source of financing for government activity, emphasizing the financing of the deficit and bond redemption. These receipts make it possible to decrease the extent of issuing government bonds that constitute an alternative financing source. The said privatization procedures and structural changes promote the creation of macro-economic conditions for the benefit of business sector and households.

In 2007, the following major privatizations took place:

- **Oil Refineries Ltd. –** In December 2004, Ministers' Committee on Privatization Matters published a decision No. 20 "the Privatization of the Oil Refineries Ltd.", regarding the splitting and privatization of the Oil Refineries Ltd. which sets the rules for the sale of government shares in Oil Refineries Ltd. and in Ashdod Oil Refineries. In January 2006, according to the decision, Ashdod Oil Refineries was established. In February 2006, Israel Corporation transferred all of its shares in Oil Refineries Ltd. (26%) to the State of Israel, ceasing to have shares at Oil Refineries Ltd. In September 2006, the splitting process of Ashdod Oil Refineries from Oil Refineries Ltd. was completed, and Ashdod Oil Refineries was sold in a competitive process to Paz Oil Company Ltd. for amount of approximately 3.25 billion NIS gross. Upon completion of the splitting of Ashdod Oil Refineries from Oil Refineries Ltd. and the sale of Ashdod Oil Refineries, the second phase of implementing the Ministers' Committee's decision was begun – the sale of the state holdings in Oil refineries Ltd. to the public in the form of offer for sale on TASE.. In February 2007, the offer for sale of the state shares in Oil refineries Ltd. was completed in for an amount of approximately 6.43 billion NIS. As part of the offer for sale, Israel Corporation Ltd. together with Petroleum Capital Holdings Ltd. acquired approximately 46% of Oil Refineries Ltd. share capital.

- **Pi Glilot Oil Terminals and Pipes Ltd. –** In May 2005 a decision was made by the Ministers' Committee on Privatization Matters regarding the privatization of the company. On August 1st 2007, Pi Glilot terminals were sold to Delek Ltd. for 800 million NIS. The company paid dividends to the State of Israel on two dates: 75 million NIS on November 15th 2007 and 15 million NIS on December 28th 2007.

As part of maintaining the relevance principle of these data, the financial statements of 2007 included the state holdings in government companies on the basis of the financial statements of the government companies that are under the responsibility of the government companies' authority. Within this framework, the government companies' data was based on the updated information held by the government companies' authority, including drafts of the government companies' financial statements as of December 31st 2007. In cases where the said financial statements have not been received, the data was based on the quarterly financial statements of the third quarter of 2007 as well as on the financial statements of December 31st 2006, and other financial statements drafts (see Appendix A).

Note 2 – Accounting policy principles:

a) General:

The financial statements are prepared according to government accounting standards and generally accepted accounting principles, as outlined below. At the time of preparing the financial statements and presenting them in accordance with the accepted accounting principles, the administration of the various government ministries were required to carry out estimates and make assumptions that affect the data presented in the financial statements and the notes accompanying them. Due to the nature of estimates and assumptions, the actual results might be different.

b) Information Systems:

The financial statements are based on the execution data as registered in various financial systems of various government ministries, among them: a general system for government ministries that has been assimilated in approximately half of all government ministries (hereinafter: Merkava), an accounting decentralization and management system (hereinafter: ADM), an IBM system at the Accountant General, Aviv Financial systems at state hospitals and additional designated systems that are used by various ministries. **This data is unaudited.**

The government of Israel began implementing Merkava in 2000. The Merkava Project is an organizational-infrastructure covering all the administrative systems within the government array. The project's goal is to effectively manage the state assets and resources. The topics handled by Merkava include financial management, payment execution, state liabilities, state assets, human resources, transfers and supports. Merkava is assimilated as mentioned earlier in a gradual process in some of the government ministries, including the conversion of data from old IT systems. The financial statements data are affected, as aforesaid, by the implications that could arise from the conversion of data to the system – with all implications involved.

c) Reporting basis:

The government of Israel is undergoing an accounting reform that involves transition to accrual basis of accounting. As of December 31st 2007, approximately half of the government ministries have transferred to reporting on an accrual basis of accounting. The notes below include details regarding the transition to an accrual basis.

d) Definitions:

In these financial statements:

The Government	-	Government of the State of Israel
Economic entity	-	Groups of entities, including a controlling entity and one or more controlled entities
Associated entities	-	Entities in which the investor has substantial influence and they are not controlled entities nor the investor's joint ventures
Controlled entities (consolidated entities)	-	Entities controlled by the government (controlling entity), their financial statements are consolidated with the government statements, excluding entities under joint control.
Joint controlled entities (consolidated by relative consolidation)	-	Entities held by joint control by all holders whose statements are consolidated with the ministry statements in the form of relative consolidation.

Held entities	-	Consolidated entities or entities consolidated by relative consolidation or associates.
Government entity	-	All government ministries and its auxiliary units as well as statutory entities whose nature of activity is not business oriented and/or they do not operate as a closed economy.
Accountant General	-	The Accountant General division at the Ministry of Finance.
Reporting currency	-	The currency used in presenting the financial statements
Fair value	-	The amount for which an asset could be exchanged or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

e) Implementation of new government accounting standards published by the Israeli Institute for Government Accounting Standardization:

On January 1st 2007, eight new government accounting standards became effective for the first time. They are based on the International Public Sector Accounting Standards (IPSAS). The details of the new standards are as follows:

(1) **Government Accounting Standard No. 1, Presentation of Financial Statements.** The objective of this Standard is to prescribe for government entities the manner on which financial statements based on accrual basis of accounting should be presented. The Standard sets out overall consideration for presenting financial statements and specifies guidelines for their structure and minimum requirements for the content of financial statements prepared under the accrual basis of accounting. This Standard applies to the government separate financial statements as well as the consolidated financial statements of the economic entity. Standard No. 1 determines that a full system of financial statements prepared under the accrual basis of accounting includes the following components: statement on financial position; statement on financial performance; statement on changes in net assets / equity; a cash flow statement; and accounting policy and notes to the financial statements. The financial statements presented above do not include statement on financial performance and cash flow statement as required according to the Standard.

(2) **Government Accounting Standard No. 2, Cash Flow Statements.** The objective of this Standard is to provide guidelines and requirements regarding statement on changes in cash and cash equivalents of an entity, in a cash flow statement classifying the cash flow during the period by operating activities, investing activities and financing activities. The government has not yet implemented the Standard in its financial statements, and therefore, the government cash flow statements and consolidated financial statements have not yet been presented.

(3) **Government Accounting Standard No. 3, Accounting Policies, Changes in Accounting Estimates and Errors.** The objective of this Standard is to prescribe the criteria for selecting and changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and the correction of errors.

Starting January 1st 2007, the Government implements in its statements some of the guidelines of Government Accounting Standard No. 3. Therefore, the Government chose to include the amounts rising from correcting material prior period errors, changes in the accounting policy in the net surplus/deficit for the current period in one lump sum, without restating the comparative amounts, since it was impracticable to determine either the period specific effects or the cumulative effect of the errors or policy changes. Pro forma comparative information required in accordance with the guidelines of Standard No. 3 has not been presented either.

(4) **Government Accounting Standard No. 9, Revenue from Exchange Transactions.** Starting on January 1st 2007, Government Accounting Standard No. 9 has been in effect. The objective of the Standard is to prescribe the accounting treatment – recognition, accounting measurement, presentation and disclosure - of revenue arising from sale of goods, rendering of services and use made by others of the entity's assets, royalties and dividends. This Standard is not implemented at this stage since the statement on financial performance of the Government of Israel has not yet been presented.

(5) **Government Accounting Standard No. 11, Construction Contracts.** The objective of this Standard is to prescribe the accounting treatment of costs and revenue associated with construction contracts. The Standard identifies the arrangements that are to be classified as construction contracts; provides guidelines on the types of construction contracts that can arise in the government sector; and specifies the basis for recognition, measurement, disclosure and presentation requirements regarding the expenses and revenue from construction contracts.

(6) **Government Accounting Standard No. 12, Inventory.** Starting on January 1st 2007, the Government is implementing Government Accounting Standard No. 12 that prescribes the accounting treatment for inventory – recognition, measurement, presentation and disclosure. According to the provisions of Standard No. 12, inventory held for the purpose of distribution at no charge or for a nominal charge, or for consumption in the production process of goods to be distributed at no charge or for a nominal charge, will be measured at the lower of cost and current replacement cost. Standard No. 12 sets out the costs that should be included in determining the cost of inventory (purchase costs, conversion costs and other costs incurred in bringing the inventory to its current state and condition), and requires the allocation of fixed overhead costs in production, based upon normal capacity of the production installations. Standard No. 12 specifies formulas for determining the cost of inventory, the date of recognizing the inventory as an expense, and the registration of the inventory depreciation and cancellation. For the purpose of measuring the inventory cost, the government ministries chose to use the method of the weighted average cost unless otherwise noted. In the financial statements presented above, a part of inventory and security inventory that exists in government ministries has not yet been recognized.

(7) **Government Accounting Standard No. 14, Events After the Reporting Date.** The objective of this Standard is to prescribe the time when reconciliation of the financial statements should be executed due to events following the reporting date, as well as the disclosure that an entity should give about the date when the financial statements were authorized for issue and about events after the reporting date.

(8) **Government Accounting Standard No. 17, Fixed Assets.** The objective of this Standard is to prescribe the accounting treatment of fixed assets while relating to the timing of assets recognition, measuring their value and the depreciation sums that are recognized in relation to them (see specification regarding the manner of implementation in the "Fixed Assets" section below).

Government ministries that report under the accrual basis of accounting implemented the Standards in their financial statements in the form of adjustments of the opening balance of the accrued surpluses or deficits, and comparative information has not been restated – unless otherwise noted.

f) Fixed Assets:

Starting on January 1st 2007, the Government is implementing Government Accounting Standard No. 17, on Fixed Assets (hereinafter: "Standard No. 17"). The Standard prescribes the accounting treatment – recognition, measurement, presentation and disclosure of fixed assets. According to the Standard, a fixed assets item that is eligible to be recognized as an asset, will first be measured at cost; when an asset is acquired with no cost or for nominal cost, its cost is its fair value on the date it is received.. The cost of a fixed assets item is the cash price on the recognition date. Following the initial recognition, the government ministries chose to carry fixed assets at its cost less any accumulated depreciation and any accumulated impairment loss. Improvements of rented assets are depreciated over the rental period or the estimated lifespan of the improvements, whichever is lower.

Directly attributable borrowing costs were not capitalized to qualifying assets until the assets were is not ready for its intended use or sale, or if the period needed in order to prepare the assets for its intended use or sale is not substantial.

Financial Statements for the year 2007, included for the first time fixed assets of the security departments in the amount of approximately 67.4 billion NIS and most of the interurban road infrastructure in the amount of 68.9 billion NIS.

Main depreciation rates are:

Class of Fixed Assets	Depreciation rates
Roads	2%
Military assets and other security dept. equipment	2.5%-5%
Buildings	4%
Medical equipment and accessories	7%-20%
Vehicles	15%-25%
Computer equipment	33%
Office equipment and furniture	7%-15%
Computerization projects	10%
Improvements of rentals	2%-10%
Machines and mechanical equipment	7%-20%

Asset statement as presented in the Financial Statements is not full and the following material assets were not yet included:

- All State land
- Most of State's investment in infrastructure
- Part of the investments in the security system
- Most assets that are allocated abroad
- Part of State real estate and equipment
- Heritage assets

Furthermore, due to constraints in allocating original ownership papers and/or disability in calculating the costs from old ownership papers, some of the assets were presented using the fair value model. Therefore, the accounting policy used in the Financial Statements is not necessarily consistent, as required by generally accepted accounting principals. A broad analysis of fixed assets classes, in order to implement a consistent accounting policy will be preformed along with Merkava ERP system implementation.

Different activities are in place in order to complete the asset statement, including:

- Updating the value of buildings that are carried in the financial systems at no value
- Updating asset survey in the Government Housing Unit
- Continued establishment of database of assets held abroad by the Foreign Ministry, Ministry of Industry, Trade and Labor, Israel Police, Ministry of Finance and Ministry of Tourism in the amount of more than 110 owned real estate assets
- Listing of assets included in the Disengagement Plan
- Establishing a plan for State's management and monitoring of compensations and expropriations of land by the State.

g) Details regarding foreign currency exchange rates and consumer price index (CPI):

The following are the details regarding the CPI, exchange rates of major foreign currencies and the rates of change during the accounting period therein:

	As of December 31st	
	2007	**2006**
Consumer Price Index (in points)	102.5	99.13
U.S. dollar exchange rate (in NIS per USD 1)	3.846	4.2250
Pound Sterling exchange rate (in NIS per Pound 1)	7.7105	8.2884
Euro exchange rate (in NIS per EURO 1)	5.6592	5.5643

	Rate of change in percentage	
	2007	**2006**
Consumer Price Index	3.4	(0.1)
U.S. dollar	(8.97)	(8.21)
Pound Sterling	(6.97)	4.38
EURO	1.7	2.16

h) Cash and cash equivalents:

Short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value are considered cash equivalents. Cash equivalents include, among other things, short-term deposits that had been deposited at the Bank of Israel or commercial banks in Israel, with maturity period that does not exceed 3 months.

i) Provision for doubtful debts

In the Financial Statements of 2007, both general provision and specific provisions were executed in accordance with the said herein (restatements have not been made for provision for doubtful debts for 2006 as result of the absence of relevant information allowing for making restatements in accordance with the format presented in 2007):

(1) **Housing loans –** Provision for housing loans is made in accordance with the mortgage banks reports. The provision is specific and is determined by the instructions of the Inspector of Banks. The provision is calculated on a graduated basis according to payment arrears. It also includes the balance of debts which payment date has not yet been reached and that are related to the aforesaid debts in arrears. Each provision bracket is at the rate of 8% of the debt, the first bracket being in arrears of over 6 months and the last one being in arrears of 33 months and higher with maximal provision of 80%. Due to the arrears interest accrued over the debt, full provision has been made. In addition, general provision has been executed on the outstanding balance of housing loans at the rate of 3%.

(2) **Housing loans for contractors –** Specific provision has been made by examining of developments or events related to the projects.

(3) **Other loans –** provision for doubtful debts was determined based upon an estimate regarding the losses involved in loans and considering the overall risks related to the financial stability of the person taking the loan / debtor, the extent and quality of information about him/her and the securities about him/her existing at the Accountant General. In addition, general provision was executed at the rate of 3% on the outstanding balances of loans given by the state.

(4) **The form of provisions for doubtful debts due to the data of 2006 –** Specific provision was executed relating only to debts in arrears. Regarding housing loans – general provision was executed at the rate of 35% of the debt in arrears. No general provision was executed on un-discharged balances.

j) Investments:

(1) **Investments in negotiable securities –**

Negotiable securities that are classified as "current assets" and carried and presented at market value or the value of proceeds as of the reporting date less expenses involved in realizing securities.

Negotiable securities that are classified as "non-current assets" are carried and presented at cost less any impairment losses that are not of a temporary nature.

(2) **Investments in convertible capital bonds** – presented at cost.

(3) **Investments in administrative property –** presented in part at nominal historic cost and in part at estimated value of realization (if lower than cost) determined by the price committee at the Ministry of Construction and Housing at the time of transferring the apartments in trust to the housing companies for the purpose of renting them.

k) Intangible assets:

Intangible assets that are presented in this statement include the variety of plants protected by cultivators' rights (hereinafter – the "variety") that had been developed and registered by the Agricultural Research Administration (herein – Volcanic Institute) at the Ministry of Agriculture, and the available administration's website. The status of the said assets is incomplete and does not include many of the intellectual property assets existing mainly within the health system and the Ministry of Defense.

The recognition and measurement rules of the said intangible assets are in accordance with the provisions of International Accounting Standard, IAS 38 – Intangible Assets. According to the standard's provisions, the assets were measured at historic cost, less any accumulated amortization and any accumulated impairment losses (see Note 13 hereinafter).

As a rule, government institutions in the State of Israel, in which studies are conducted, do not act either to protect the know-how or technology that belong to the state, or to realize their commercial potential. This is in contrast to the situation existing in most western countries that have started as early as the 1980s to establish economic and legal infrastructures intended to commercially implement know-how and intellectual property under government ownership. As result of not protecting know-how, its potential to be turned into a usable product is impaired, the entire public interest is impaired, and the ability to develop enterprises on the basis of that know-how, such as new manufacturing plants that could serve as a basis for increased employment and increased state revenues from taxes is impaired as well.
The Accountant General is acting these days along with relevant entities to handle the issue of intellectual property owned by the government.

l) Benefits for employees:

Benefits for short-term employee benefits are registered at the same time of the service provided by employees. These benefits include salary and accompanying items, such as vacation pay, sick pay, bonuses and allowances.

m) Allowance for vacation:

The government liability due to its employees' right to vacation pay was not presented in this statement, as required by acceptable accounting principles.

n) Public Private Partnerships:

No binding Israeli or International document has yet been published regarding accounting treatment of PPP (Public Private Partnership) on part of the transaction contractee. Therefore, the accounting policy that had been implemented on existing arrangements was prepared in accordance with the draft of the international accounting standard for the public sector in regard to this matter. The government recognizes the assets in PPP transactions, provided that the two following conditions are met:

(1) The contractee controls or regulates which services the operator has to provide regarding the underlying asset, to whom the operator has to provide them and for what price; and

(2) The contractee controls – through ownership, entitlement to benefits or in any other way – any residual material right to the underlying asset upon the end of the contract.

According to the accounting policy that had been implemented, in arrangements that include a component of construction of an asset, the government recognizes the asset from the construction phase, only if it carries most of the risks involved in this phase. The change on the accounting policy had been implemented in advance and was reported as reconciliation of the opening balance of surplus. The comparative amounts for 2006 had been re-presented.

In arrangements where it is possible to separate the service component and the construction component, it is necessary to first measure the asset and the related liability in accordance with the fair value of the asset, or in accordance with the current value of payments for construction – whichever lower. Due to absence of data regarding the fair value of assets, assets with known cost data, were recognized at cost, and assets with unknown cost, were recognized at current value of payments due to construction.

In arrangements in which it is impossible to separate the service component and the construction component, it is necessary to first measure the asset and the related liability in accordance with the fair value of the asset. Due to the absence of data regarding the fair value of assets, assets and the related liability were recognized at actual cost of set-up.

o) Leases:

In September 2007, the Israeli Institute for government accounting standards published its Government Accounting Standard No. 13 regarding "Leases" (hereinafter: "Standard 13") setting the accounting treatment – recognition, measurement, presentation and disclosure – regarding finance leases or operating leases. Standard 13 specifies the characteristics of transactions that will help the entity classify a lease as a finance lease or operating lease, and determines as follows:

(1) At the beginning of a finance lease period, the lessees have to recognize the assets that had been acquired through a finance leasing as assets, and recognize the liabilities related to the leasing as liabilities in their statements on financial position. The Standard requires that assets and liabilities will be recognized at amounts equal to the fair value of the leased property or to the current value of the minimal leasing payments, whichever is lower, while each of them is determined at the beginning of the lease term. Due to the absence of data regarding the far value of the assets, the assets will be recognized in a finance lease at actual construction cost.

(2) In operational lease, the leasing payments will be recognized as an expense on a straight line basis throughout the leasing period unless another basis better presents the user's pattern of benefits over time.

p) Allowances, contingent liabilities and contingent assets:

In May 2007, the Israeli Institute for government accounting standards published its Government Accounting Standard No. 19 regarding "Provisions, Contingent Liabilities and Contingent Assets" (hereinafter: "Standard 19") setting the principles for recognition, measurement and disclosure of provisions, contingent liabilities and contingent assets. Standard 19 distinguishes between provisions and contingent liabilities as follows:

(1) Provisions – Recognized as liabilities (assuming that it is possible to make a reliable estimate of them and assuming that they follow the definition of liability).

(2) Contingent liabilities – are not recognized as liabilities, since they are possible obligations or existing obligations that do not meet the principles of recognition set in Standard 19.

(3) Contingent assets – Standard 19 determines that an entity shall not recognize contingent assets.

According to the requirements of the standard, appropriate provision was first presented in 2007 financial statements regarding lawsuits filed against the State, at the amount of approximately NIS 3,400 million. In addition, contingent liabilities due to lawsuits that totaled approximately NIS 20 billion and information regarding contingent assets liable to tax totaling approximately NIS 56 billion were presented in the notes to the financial statements.

.