



# **GOVERNMENT OF THE STATE OF ISRAEL**

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## **ESSENCE OF FINANCIAL STATEMENTS**

AS OF DECEMBER 31 2012  
(UNAUDITED)

**State of Israel**  
**Ministry of Finance – Accountant General**  
**Government of Israel – Financial Statements as of December 31 2012**

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**ACCOUNTANT GENERAL**  
**MINISTRY OF FINANCE**  
**STATE OF ISRAEL**

May 30, 2013

To  
The Users of the Financial Statements,

I am honored to present the financial statements of the Government of the State of Israel for the year ended December 31, 2012. The financial statements are prepared in accordance with accounting standards that are based on the International Public Sector Accounting Standards (IPSAS), which are implemented in the Western World's leading countries.

For the first time, the financial statements include information of the Government activity - the Government ministries, divisions, government companies, the National Insurance Institution - according to four major areas of operation consisting of 12 secondary domains. This presentation gives another view of the assets and the results of government activity.

The National Insurance Institution published audited financial statements for the first time in April this year, so unlike previous years, the financial statements of the Government include audited data. This is the second year that the notes to these financial statements include disclosure of the appraisal of lands held by the Government, and disclosure on royalties from natural resources. In addition, for December 31, 2012, the levy for petroleum profits was included as part of the Government's funds as a Sovereign Wealth Fund, as recommended in the "Shishinski" Law.

Further to significant progress in the State of Israel's financial reporting and the material reform of government accounting, the application of the consolidated financial statements has been expanded to include the financial statements of Government ministries and divisions on an accrual basis – mostly audited by independent auditors. In addition, the financial statements of 66 Government companies were consolidated. The Office of the Accountant General continually reviews the prospective consolidation of additional public entities in the financial statements, which could be reflected within the next few years.

I would like to take this opportunity to thank all those engaged in the important task of producing and preparing the consolidated financial statements of the Government of the State of Israel, led by the Department of Accounting and Reporting in the Accountant General Division, the chief accountants and comptrollers of the Government ministries, the Government Companies Authority and the Chief Financial Officers of government companies.

Sincerely,  
**Michal Abadi-Boiangiu**



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**PART A**

**PREFACE TO THE FINANCIAL  
STATEMENTS OF THE  
GOVERNMENT OF THE STATE  
OF ISRAEL**

**AS OF DECEMBER 31 2012  
(UNAUDITED)**

## **1. GENERAL**

Over the last decade, the Government of Israel joined governments of leading nations in the Western World that have introduced far-reaching reforms in government accounting, intended to provide adequate disclosure and transparency as to their financial activity. As a result, on August 5, 2004, at the Accountant General's initiative, the Government of Israel passed Government Resolution No. 2375 regarding the adoption and implementation of International Public Sector Accounting Standards (IPSAS) by government ministries and by non-commercial statutory corporations.

In light of the Government Resolution, the Government of Israel has been engaged – over the last few years – in the process of instituting a reform in government accounting, which mainly involves: a gradual adoption of International Public Sector Accounting Standards; accounting-based management of the State's assets and liabilities; transitioning from cash-based reporting to accrual-based reporting; as well as enhancing the reliability of financial reporting through independent auditing of the financial statements. The reform aims to provide the general public, decision makers, and other users of the financial statements with reliable and comprehensive information regarding to the financial position of the Government of Israel, in the belief that transparency is one of the cornerstones of proper and efficient administration.

The financial statements filed herewith constitute yet another step in the implementation of the accounting reform led by the Accountant General in the past few years.

### **Independent auditing of financial statement data**

The Government of Israel's consolidated financial statements for 2012 are unaudited. However, the Accountant General is leading a gradual process of transitioning Government ministries and units to accrual-based financial reporting, as well as appointing independent auditors to audit their financial statements. The Government of Israel's consolidated financial statements for the 2012 fiscal year were prepared according to a hierarchical structure, which is mainly based on accounting principles regarding consolidation of financial statements, and which is being developed as part of the accounting reform under way in all government ministries and units.

A significant part of the data in the financial statements is presented according to International Public Sector Accounting Standards. However, it should be noted that the statement of assets presented herein does not represent all the assets held by the State of Israel. Not included are numerous assets with highly material value or cost, such as: assets, a significant part of the State's investment in the defense sector, all State land, all heritage assets, some of the assets abroad and intangible assets.

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Furthermore, it should be noted that the information regarding the Government of Israel's assets and liabilities is not based on a unified accounting and reporting system. The accounting systems used in some of the government ministries do not support financial information on an accrual basis and some government ministries still report on a cash basis. Some of the financial information is unaudited and is based, among others, on auxiliary systems used alongside the main accounting system, as well as on reports received from various bodies which administer certain assets and liabilities on behalf of the Government of Israel. The Accountant General does not have full information regarding the quality of the control processes instituted in some of the aforesaid bodies. The database used in the preparation of data for the financial statements, mostly regarding property, plant and equipment, is not a closed accounting and reporting system. Therefore, it is impossible to verify data completeness, which is essential for determining that the statements of financial position encompass all of the assets and liabilities of the Government of Israel, or that the statements of financial performance adequately reflect the results of the Government of Israel's operations and are prepared in accordance with generally accepted accounting principles.

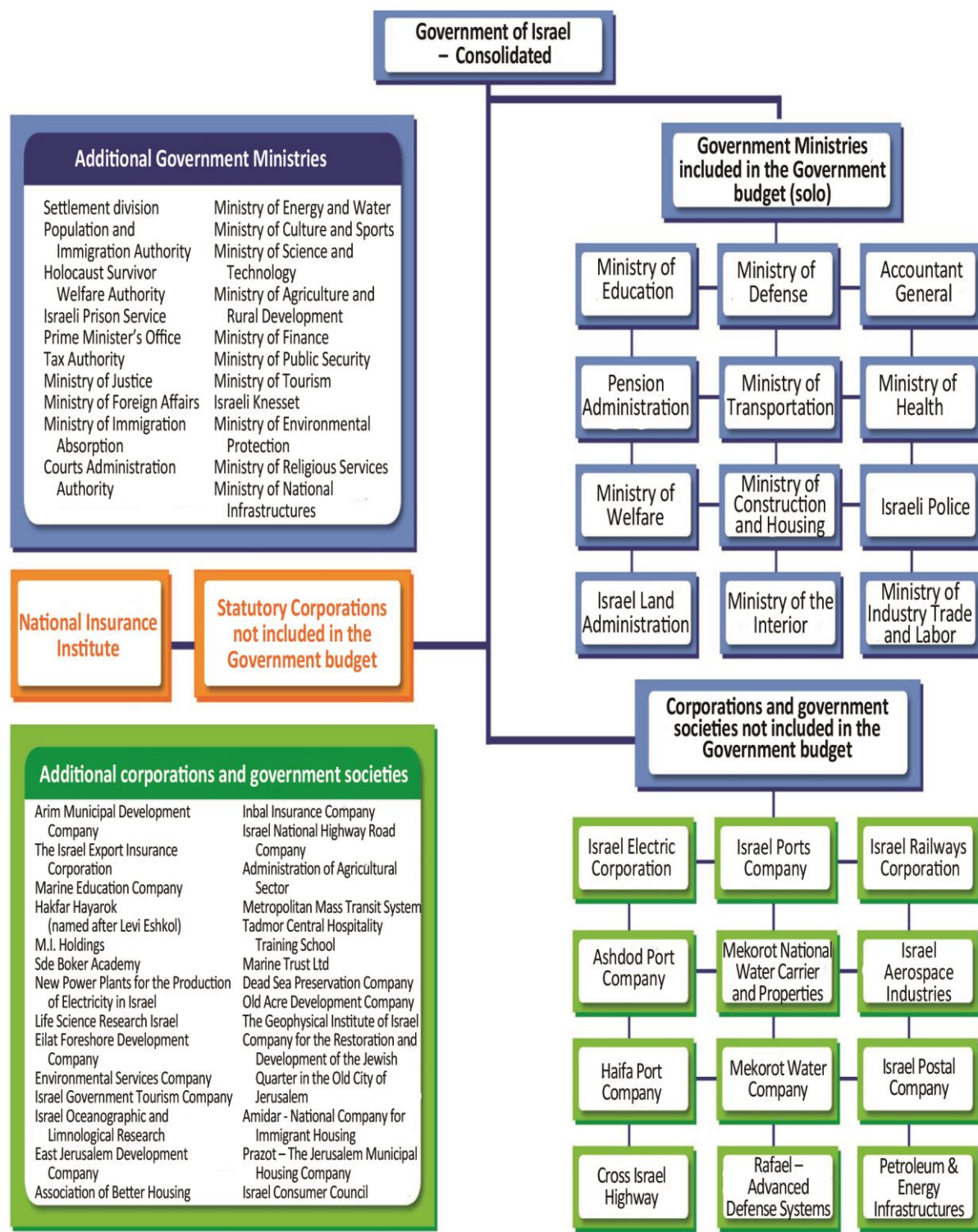
The net accounting deficit does not reflect the Government of Israel's budgetary deficit, as it is calculated using altogether different measurement methods, which are based on accrual-basis general accounting accepted principles. These principles express changes in assets and liabilities which are not necessarily related to cash flow and which are not fully reflected in the State budget, in accordance with the Budget Foundations Law and with the budgetary deficit measurement method common around the world.

The net accounting deficit reflects expenses which are accounted for in the present, but which will only materialize as a cash expense and budgetary charge in the future, if at all, and so this accounting deficit does not require current financing.

An example thereof is expenses for employee benefits that are already recognized, and arising from increased employee entitlement to pension, based on actuarial calculations, but which shall only materialize following each employee's retirement and which shall be spread in the cash flow over the years according to actual pension payments. Despite the transition to cumulative pension and the maintaining of the population entitled to budgetary pension at a constant level, a shorter discount period for the liability in respect of this period creates a material actuarial accounting cost, which will have a significant effect in the coming years and will then gradually decrease as we progress towards the date on which the State shall no longer have any obligation in this regard.

Another material component in the net accounting deficit is the financing expenses for the entire government debt, including linkage differentials and interest payable, which have been accrued but are not yet due. It should be emphasized that in the budgetary deficit these expenses are only expressed upon their actual realization, that is, at the time of payment.

**2. THE CONSOLIDATED FINANCIAL STATEMENTS APPLY TO:**





### **3. MAIN DIFFERENCES AS COMPARED WITH FINANCIAL STATEMENT DATA FOR THE 2011 FISCAL YEAR**

The Accountant General's annual work plan emphasized that steps should be taken which will lead to significant improvements in reporting quality for fiscal year 2012. Key changes include the following:

#### **1. Presentation according to areas of activity**

For the first time the Government of Israel's financial statements (see part c), include presentation according to areas of Government activity - the Government ministries, divisions, government companies, the National Insurance Institution.

The presentation is according to four major areas of operation consisting of 12 secondary domains. This presentation gives another view of the assets and the results of government activity.

#### **2. Consolidation of Statutory Bodies**

This is the first year that the financial statements of the Government include audited financial statements of the National Insurance Institution.

In April, the National Insurance Institution published audited financial statements for the first time, so unlike in previous years, the financial statements of the Government include audited data.

#### **3. Increasing the quality and reliability of the financial statements**

The Government of Israel's financial statements for 2012 include audited financial data (by independent auditors) for 51 government ministries and divisions (out of 86 government ministries and divisions), whose budgets account for approximately 77% of the total budgeted expenses of Government ministries. As aforesaid, the independent auditing of financial statements for Government ministries was significantly enhanced this year, thus increasing the reliability of financial reporting, strengthening the internal control over the work of Government ministries, and increasing the overall relevancy of the financial statements as a managerial tool for making strategic decisions

#### **4. Consolidation of government companies**

For the first time, the Government of Israel's financial statements for 2010, consolidated the financial statements of Government companies controlled by the Government, for financial reporting purposes, in accordance with the criteria established in Israel Government Accounting Standard No. 6 – “Consolidated and Separate Financial Statements” (Revised 2010). In the framework of these financial statements, 66 government companies controlled by the Government were consolidated for financial reporting purposes. The consolidation was done by using a computerized system with the financial data directly reported by the companies, with the cooperation of the Government Companies Authority. This process constitutes yet another step in the continued improvement in reporting credibility. The presentation of the Government's financial position and financial performance in a consolidated format provides users of financial statements economic information regarding the activity of the Government and its various branches, in

accordance with international financial reporting standards. It should be noted, however, that some Government companies have yet to file audited financial statements as of December 31 2012. Therefore, the consolidated data for Government companies is based, in many cases, on unaudited draft financial statements as of December 31 2012, or on interim financial statements for the third quarter of 2012 as well as on annual reports as of December 31, 2011, and/or on drafts of such financial statements as of the above mentioned dates.

**5. State-owned lands**

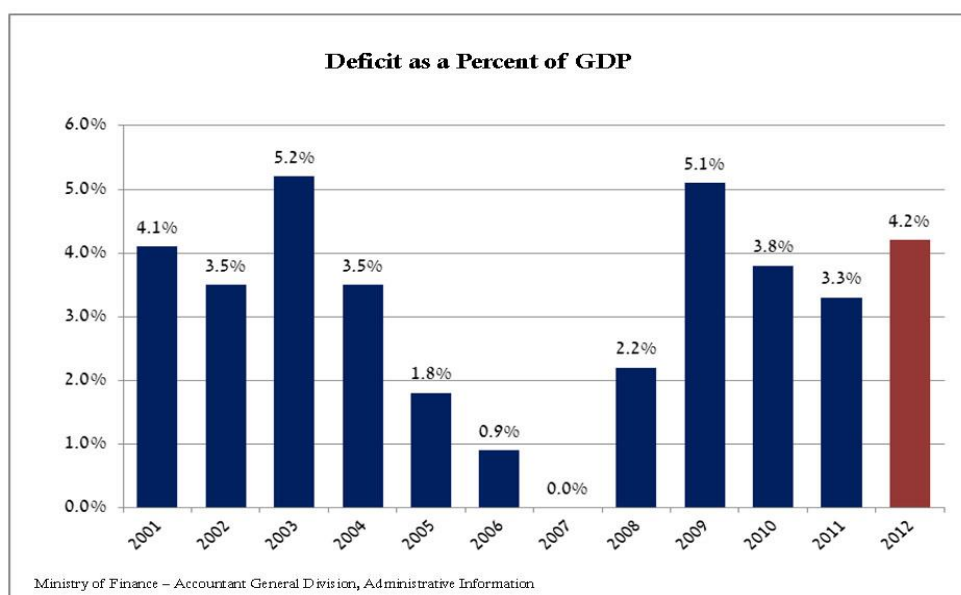
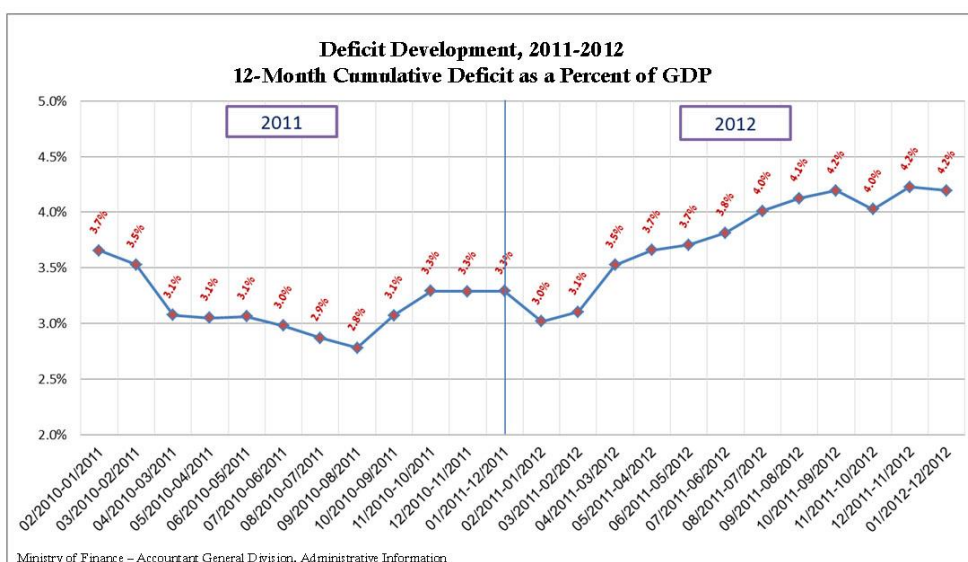
This is the second year that the notes to these financial statements include disclosure regarding the estimated value of State-owned lands. The fair value estimate was made in accordance with an economic and accounting methodology that was developed by the Chief Accountant with the cooperation of the Division of Land Appraisal of the Ministry of Justice (hereinafter – “the State Appraiser”) and the Israel Land Authority (hereinafter – “the ILA”).

**6. Royalties from natural resources -**

This is the second year that the notes to these financial statements include disclosure on the estimated value of royalties payable to the government in respect of natural resources. The estimated value of future royalties for contingent asset disclosure purposes was determined based on the current value of future royalties derived, among others, from the projected level of extraction of resources in the concession area, the estimated selling price, the period of production and the effective royalty rate that takes into account different variables and acceptable discount rates in this industry.

#### 4. GOVERNMENT DEFICIT AND FUNDING OF THE DEFICIT IN 2012

The government budget deficit for 2012 was NIS 39 billion, equivalent to 4.2% of GDP, based on an annual GDP of NIS 929.4 billion reported by the Central Bureau of Statistics. The first graph shows the monthly development of the deficit in 2011 and 2012. The second graph shows the development of the deficit as a percent of GDP in the last 12 years. The original budget for 2012 was planned to include a deficit of NIS 18.3 billion, equivalent to 2% of GDP. Expanded information on the government's revenues and expenditures can be found in the budget performance report for 2012 in Part D of the financial statements. The main reason for the deviation from the deficit target was the actual collection of lower tax revenues than the budget forecast. On the expenditure side there was a slight deviation from the original budget enabled by relatively high utilization of budget surpluses transferred from year to year.



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## 5. SUMMARY FINANCIAL STATEMENTS DATA

### FINANCIAL ANALYSIS OF THE FINANCIAL STATEMENTS

The Government of Israel's financial statements for fiscal year 2012 provide the Government, the Knesset and the general public with a comprehensive overview of the manner in which the executive authority manages its overall resources. The findings of the summary financial analysis of the financial statements focus on the government level and do not go into detail, in order to provide a general picture of the Government of Israel's financial position and its operating results as a single economic entity. The Government of Israel's operations are financed primarily through tax proceeds, which serve for realizing the Government of Israel's policies in a range of areas, as follows: Government and administration, society or social welfare, infrastructures, defense, and internal security. Detailed information regarding the Government of Israel's revenues and expenses, its assets and liabilities, along with other important financial issues, is presented in the full financial statements and the accompanying notes. That information may contribute to a better understanding of economic Government processes which influence the State and its citizens, thus contributing to their improvement.

### SUMMARY FINANCIAL DATA FOR THE GOVERNMENT OF ISRAEL (NIS BILLIONS)

	<u>Consolidated</u>		<u>Government of Israel</u>	
	For the year ended Dec. 31 <u>2012</u>	For the year ended Dec. 31 <u>2011</u>	For the year ended Dec. 31 <u>2012</u>	For the year ended Dec. 31 <u>2011</u>
<b>Financial performance</b>				
Income from taxes and fees	268.5	262.7	236.4	231.1
Income from transfers	13.1	11.4	13.0	11.4
Income from exchange transactions	75.7	75.8	23.7	26.9
Other income	7.8	7.3	7.2	6.9
<b>Total income</b>	<b><u>365.1</u></b>	<b><u>357.2</u></b>	<b><u>280.3</u></b>	<b><u>276.3</u></b>
Payroll and employee benefits	112.4	126.4	93.8	111.0
Appropriations, allocations and transfers	223.0	193.7	132.4	135.5
Operating expenses	98.9	92.4	66.8	61.8
Administrative expenses, public relations and other costs	7.9	10.5	5.6	6.8
Financing expenses, net	36.6	44.8	44.4	53.8
<b>Total expenses</b>	<b><u>478.8</u></b>	<b><u>467.8</u></b>	<b><u>343.0</u></b>	<b><u>368.9</u></b>
Share of profits (losses) of investees	0.1	0.1	(50.9)	(17.9)
<b>Net accounting deficit (*)</b>	<b><u>(113.6)</u></b>	<b><u>(110.5)</u></b>	<b><u>(113.6)</u></b>	<b><u>(110.5)</u></b>
<b>Financial position</b>				
Current assets	102.4	96.7	56.8	53.9
Financial investments and loans	60.9	61.7	108.7	109.9
Property, plant and equipment	325.1	313.6	209.9	202.9
Other assets	3.7	3.5	1.6	1.6
<b>Total assets</b>	<b><u>492.1</u></b>	<b><u>475.5</u></b>	<b><u>377.0</u></b>	<b><u>368.3</u></b>
Current liabilities	154.5	152.7	110.8	113.4
Long-term domestic and foreign loans	632.8	585.0	752.5	701.5
Liabilities in respect of employee benefits	593.1	579.0	580.8	567.7
Reserves from insurance events	440.8	383.3	4.3	3.9
Other long-term liabilities	180.6	176.3	438.6	382.9
<b>Total liabilities</b>	<b><u>2,001.8</u></b>	<b><u>1,876.3</u></b>	<b><u>1,887.0</u></b>	<b><u>1,769.4</u></b>
<b>Net liabilities / deficit (*)</b>	<b><u>(1,509.7)</u></b>	<b><u>(1,400.8)</u></b>	<b><u>(1,510.0)</u></b>	<b><u>(1,401.1)</u></b>

(\*) The net accounting deficit and equity in the consolidated financial statements include the minority interests and holders of minority interests.

## NET ACCOUNTING DEFICIT VS. BUDGET DEFICIT (NIS MILLIONS)

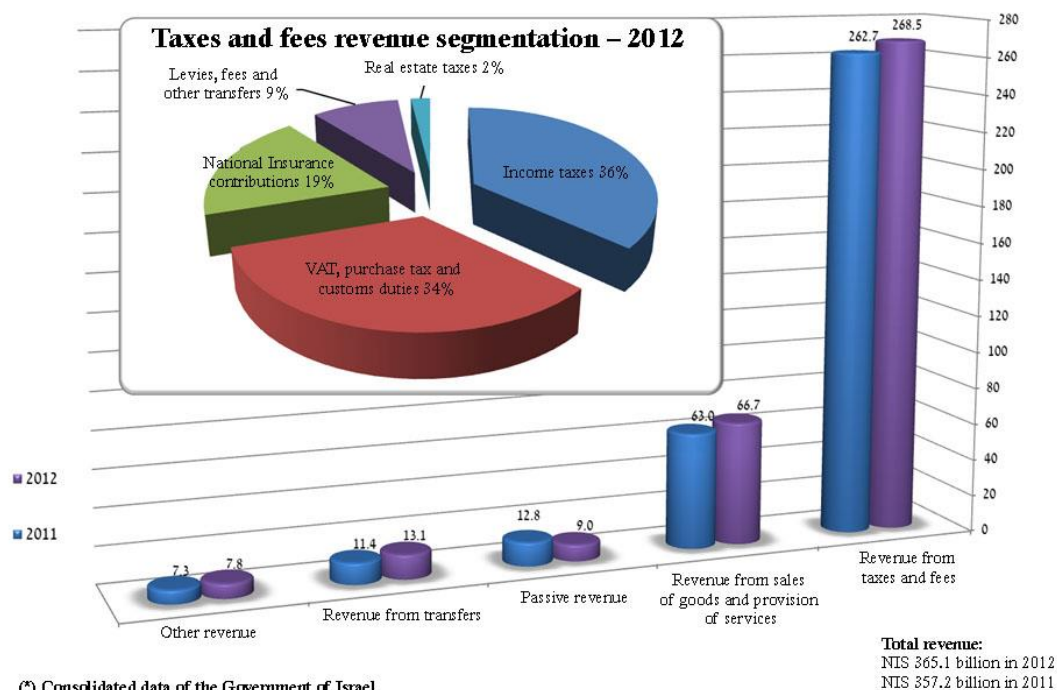
<u>Government of Israel</u>	<u>For the year ended December 31, 2012</u>
<b>Budget deficit (*)</b>	<b>38,982</b>
Employee benefits – actuarial expenses less payments	13,113
Losses of investees not expressed in the budget	50,761
Government loans – net financing expenses less cash payments	6,059
Net changes in the National Insurance Institute loan	4,655
Support of pension funds – expenses incurred less payments	4,657
Property plant and equipment – depreciation expenses less cash purchases during the year	(6,267)
Government loans – net financing income less cash proceeds	(451)
Lawsuits and other long-term liabilities	(1,293)
Debtors of exchange and non-exchange transactions, net	1,225
Short-term provisions and eligible balances	3,045
Other changes in assets and liabilities	(876)
<b>Net accounting deficit</b>	<b><u>113,610</u></b>

(\*) See Part D – Budget Implementation Reports for 2012.

<u>Financial statements – accrual-based</u>	<u>Budget implementation report – cash-based</u>
<ul style="list-style-type: none"> <li>• Financial statements provide comprehensive information on the Government of Israel’s financial position, supporting decision making and presenting Government accountability in the use of its resources.</li> <li>• Revenues – recognized when incurred regardless of their collection date.</li> <li>• Expenses – recognizes when the obligation is established regardless of the date of repayment.</li> </ul>	<ul style="list-style-type: none"> <li>• The budget implementation report describes the manner in which the Government of Israel uses its available resources in a given period, in order to achieve its objectives during that period.</li> <li>• Proceeds – amounts received in cash such as taxes and fees collected.</li> <li>• Payments – amounts paid in cash such as pension payments.</li> </ul>

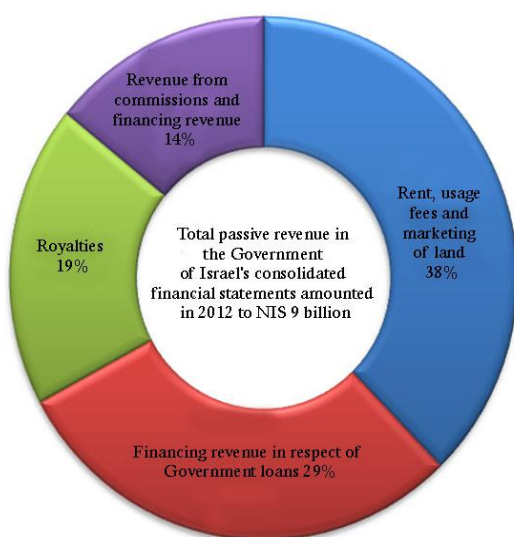
## ANALYSIS OF SELECT FINANCIAL DATA FROM THE GOVERNMENT OF ISRAEL'S CONSOLIDATED FINANCIAL STATEMENTS

### Government of Israel Revenue Segmentation (Billion NIS)

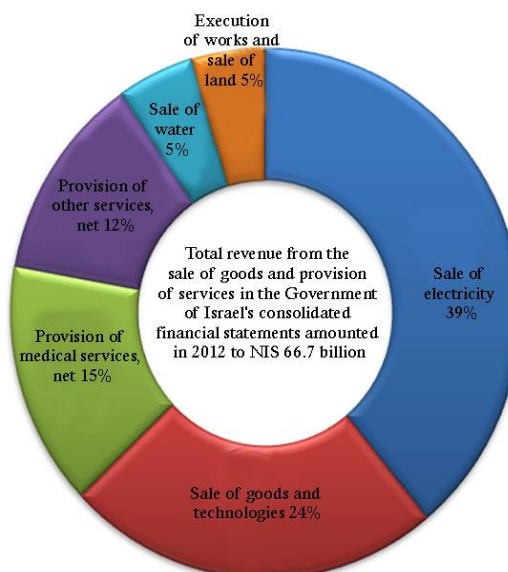


(\*) Consolidated data of the Government of Israel

#### Passive revenue segmentation

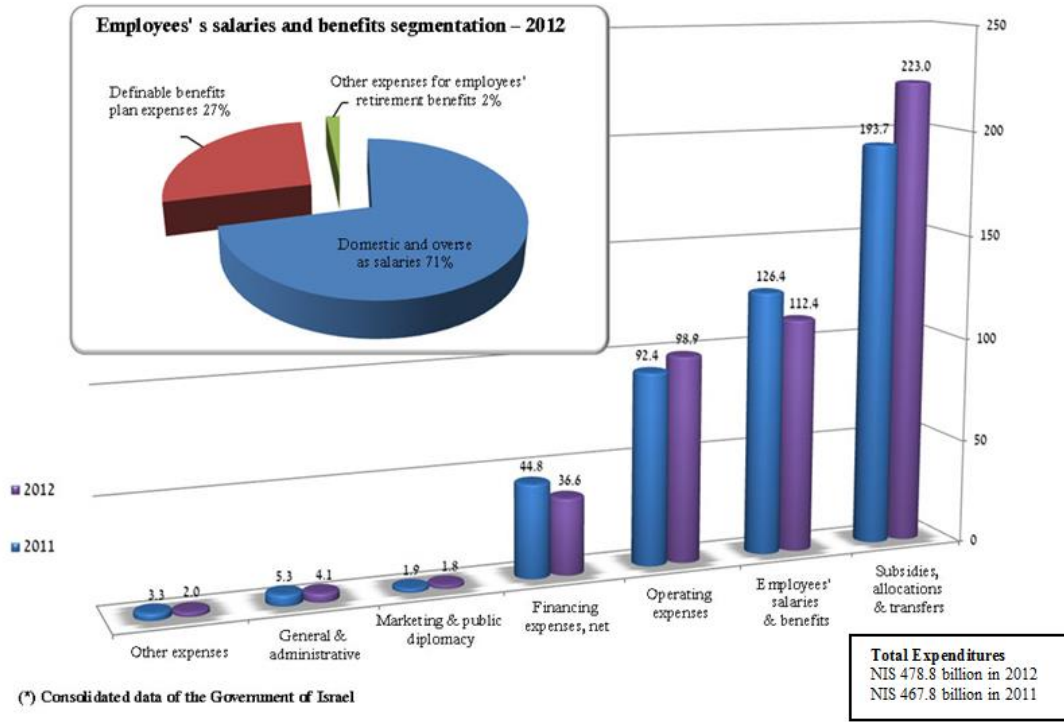


#### Sales of Goods and Provision of Services Revenue Segmentation

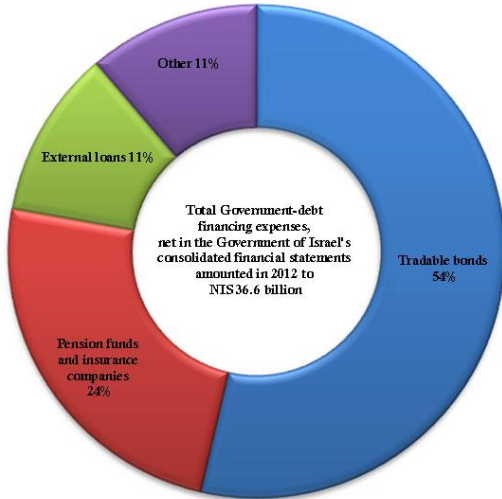




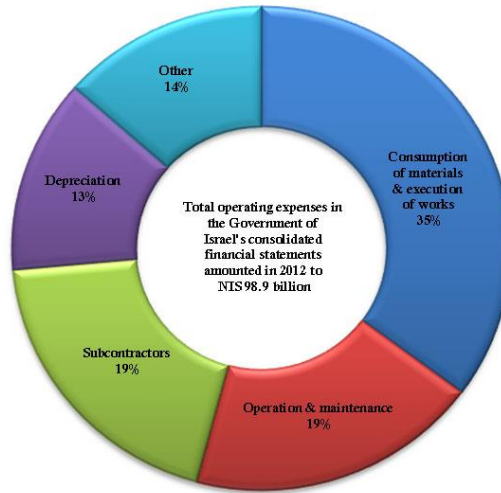
**Government of Israel Expenses Segmentation (Billion NIS)**



**Financing expenses, net segmentation**

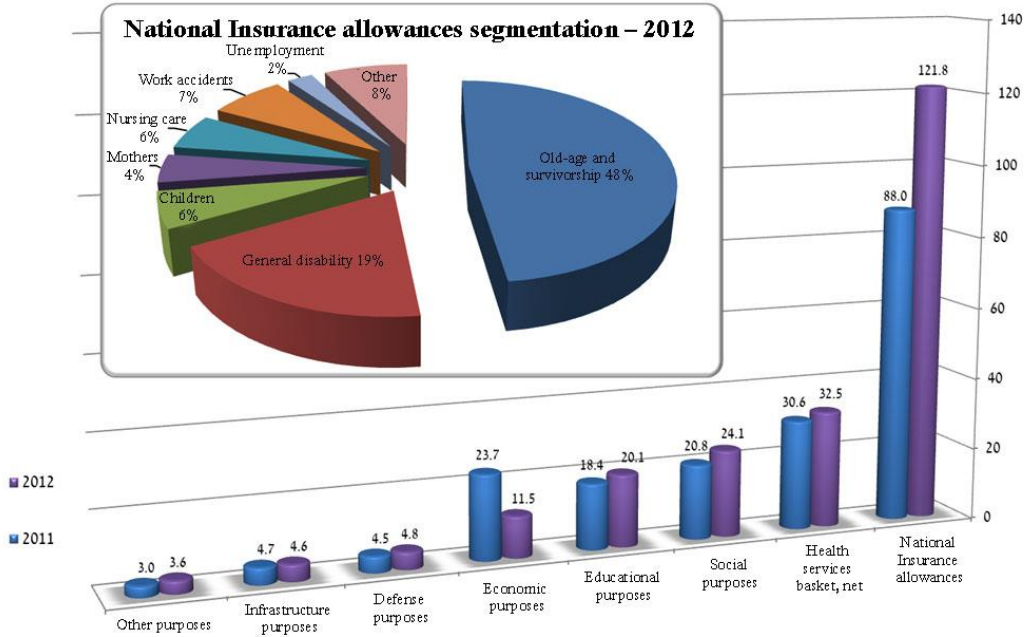


**Operating expenses segmentation**



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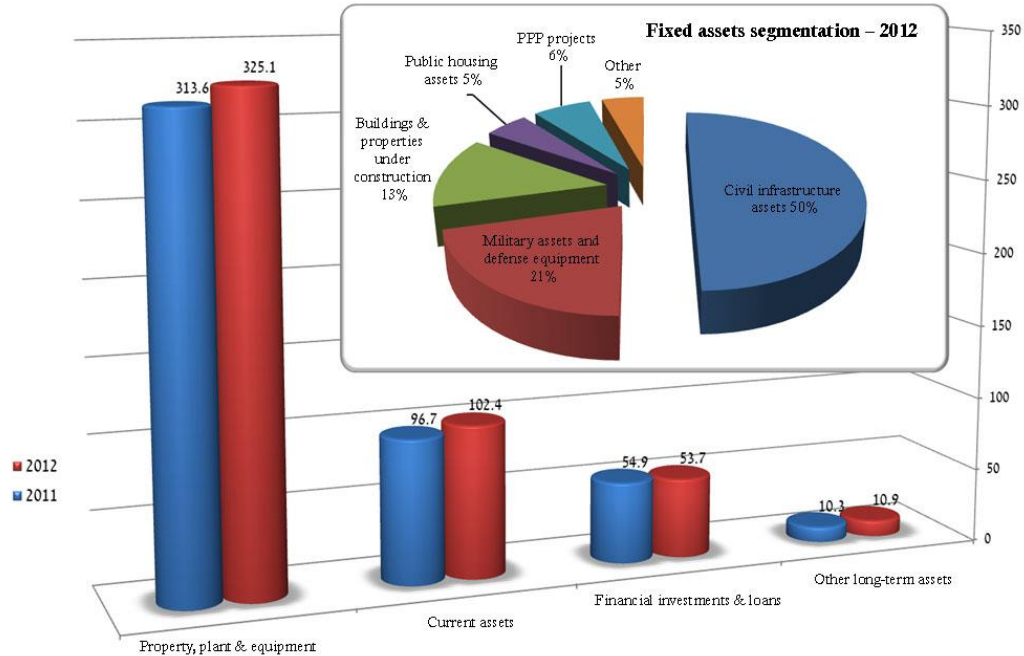
**Subsidies, Allocations & Transfers Segmentation (Billion NIS)**



**Total subsidies, allocations & transfers:**  
 NIS 223.0 billion in 2012  
 NIS 193.7 billion in 2011

(\*) Consolidated data of the Government of Israel

**Government of Israel Assets Composition (Billion NIS)**



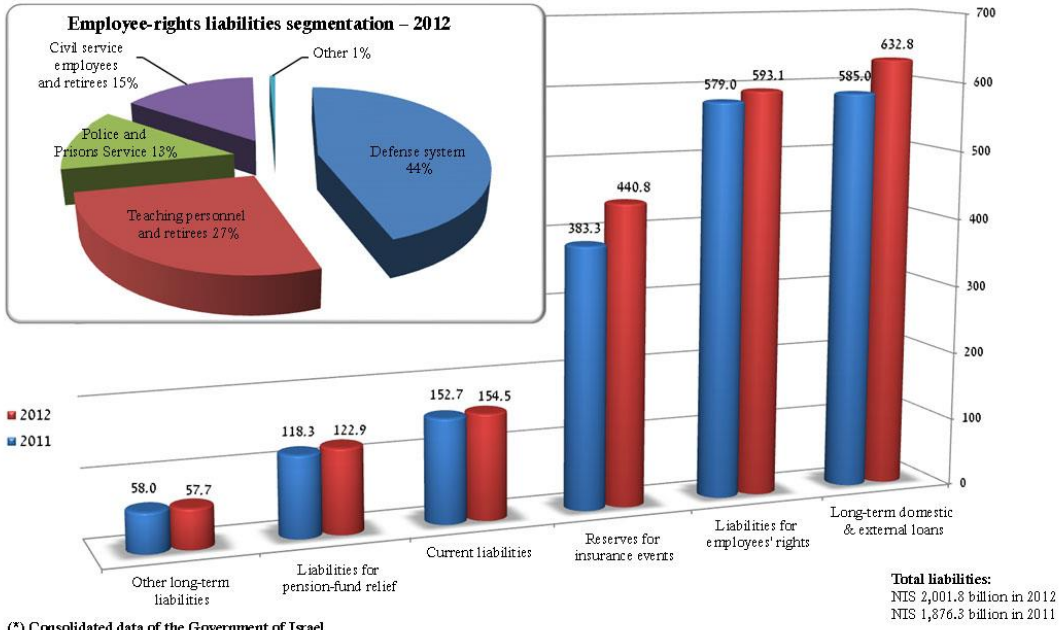
**Total assets:**  
 NIS 492.1 billion in 2012  
 NIS 475.5 billion in 2011

(\*) Consolidated data of the Government of Israel



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**Government of Israel Liabilities Composition (Billion NIS)**

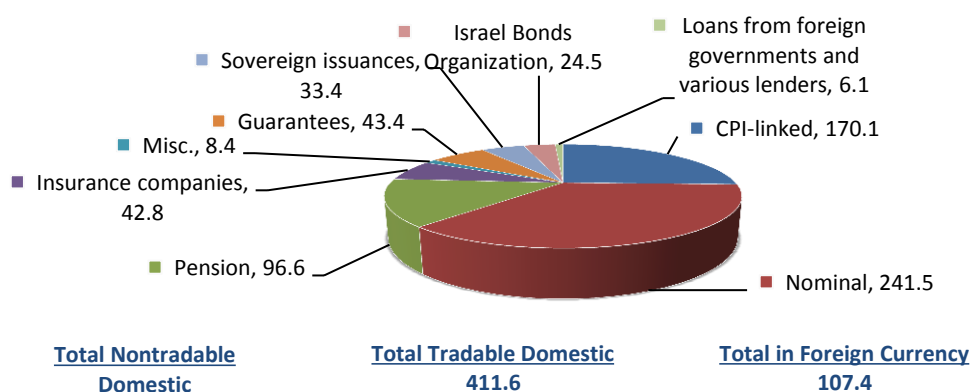


(\*) Consolidated data of the Government of Israel

## 6. GOVERNMENT DEBT

Government debt increased in 2012 by 5% to NIS 668.8 billion, compared to NIS 633 billion the year before. The bulk of the nominal increase in government debt was due to positive net funding as well as a slight increase in the consumer price index. As against this, the strengthening (appreciation) of the shekel against the dollar and the euro as well as a decrease in accrued interest, due to, among other things, low funding costs, contributed to lower government debt.

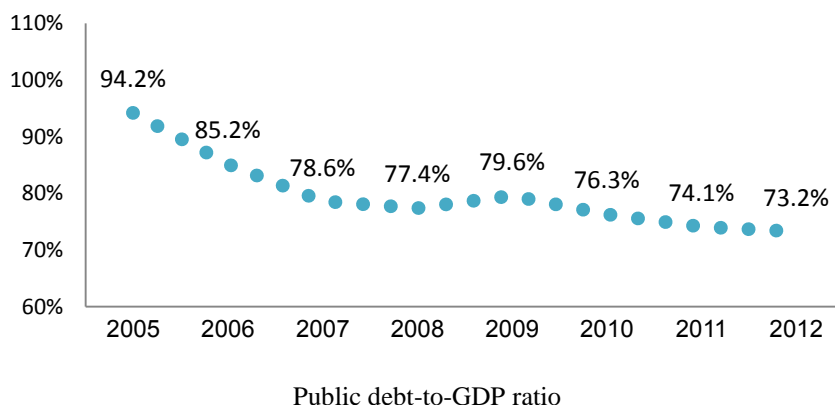
Following is the distribution of the government debt at the end of 2012 (Billion NIS):



The balance of domestic debt (tradable and non-tradable) stood at NIS 559.4 billion at the end of 2012. Tradable debt accounted for 74% and tradable debt for 26% of total domestic debt.

The government's external debt stood at the end of 2012 at NIS 107.4 billion, distributed according to the following sectors: US loan guarantee program 40%, sovereign issuances 31%, Israeli Bonds Organization 23%, and the remaining 6% comprising foreign government loans and various other loans. The average term to maturity of the total government debt stood at the end of 2012 at 6.6 years, compared to 6.3 years in 2011. The longer term to maturity stems from the policy of the Accountant General Division to lengthen the debt maturity and reduce the refinancing risk.

The volume of funding and the debt management policy directly affect the ratio of government debt to the GDP and the burden of interest expenses (interest budget) in the State budget. The ratio of government debt to GDP is an accepted measure for examining the State's financial strength, and reducing this ratio aids the State in its future financial obligations. The following graph shows the decrease in this ratio from 94.2% in 2005 to 73.2% in 2012. Further information can be found on the website of the Accountant General Division - <http://www.ag.mof.gov.il/AccountantGeneral/GovDebt>.



## 7. PUBLIC PRIVATE PARTNERSHIP (PPP) PROJECTS

The Projects Department in the Accountant General Division of the Ministry of Finance is responsible for the initiation and advancement of projects implemented in collaboration with the private sector ("PPP projects"). The projects currently underway are mainly in the areas of transportation, water, energy and construction. Advancement of the projects is done by means of inter-ministerial tender committees. The Projects Department possesses professional tools for leading these projects while providing a professional solution for all aspects of a project, including legal, financial and logistic aspects, *inter alia* on such subjects as feasibility studies, the correct distribution of risks in the project, preparation of the process documents, management of the tender process and the financial closing on behalf of the State, implementation of the tender, aiding and examination of the performance of agreements, involvement in the strategic thinking of the relevant government ministry, etc.

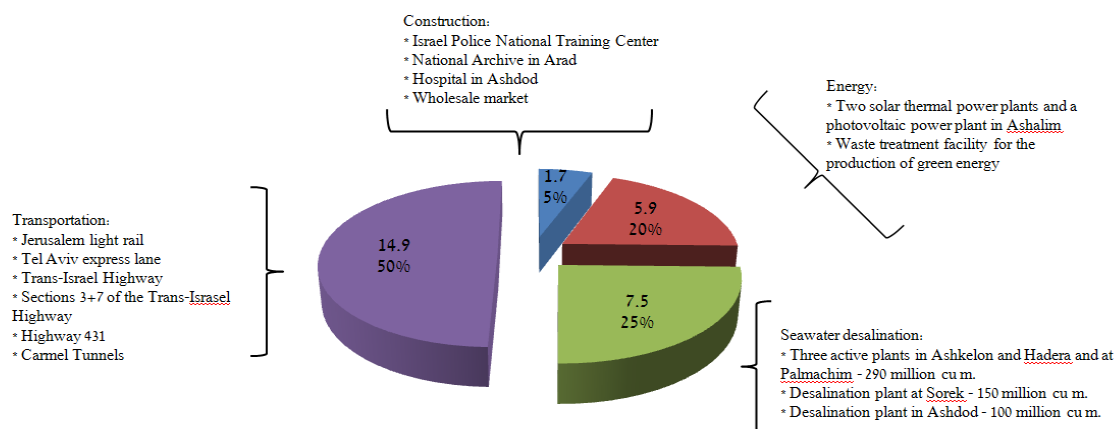
Projects based on the PPP model have been carried out in Israel for over a decade. These are investment-intensive projects for the construction of public infrastructure that are financed by the private sector under agreements between the State and private concessionaires. The assets and services in the projects constitute a public utility that benefits the economy, while the concessionaire is responsible for the planning, financing, construction and operation of the project for a fixed period. The asset is owned by the state (with the exception of BOO projects); while the level output of the service is dictated and enforced by the State. At the end of the concession period the State receives the asset in good functional condition, at no cost. Correct distribution of the risks between the private sector and the public sector ensures that each side assumes the risks it is best able to manage.

Advantages of PPP projects: improving the level of service to the State and the citizen; shortening timetables; solution for alternative financing by means of various financing entities; cost-saving over the life of the project; generating growth without an increase in the short-term government deficit; increasing competition in the market; synergy in planning, construction and operation; optimal risk distribution; implementing advanced methods and technologies (international and/or local), and maximizing the private sector's advantages in the construction and operation of projects to obtain value for money.

The key criteria for choosing PPP projects in the area of infrastructure include viability for the economy, the ability to transfer major risks to the private sector, the existence of a significant operation and maintenance component, flexibility in planning and room for innovation.

The State of Israel has a range of national targets. There is need today for the initiation of effective actions for the development of infrastructures and projects within the framework of partnerships between the different social and economic sectors. The overall investment to date in PPP projects in Israel amounts to more than NIS 19 billion. Additional projects on a scope of NIS 11.5 billion are currently in the tendering process. The total budget liability in respect of PPP projects stands today at an annual NIS 220 million (0.02% of GDP), and is expected to stand in 2022 at less than NIS 500 million (0.04% of GDP).

### Volume of Investments in PPP Projects by Area (Billion NIS)



■ Construction ■ Energy ■ Seawater Desalination ■ Transportation

Following is the breakdown by area of projects that are currently being advanced by the Projects Department, and the amounts invested in them:

**Construction:** Including the Israel Police National Training Center, the National Archive in Arad, a hospital in Ashdod and a wholesale market – for a total of NIS 1.7 billion.

**Energy:** Two solar thermal power plants and a photovoltaic power plant at Ashalim and a waste treatment facility for the production of "green energy" – for a total of NIS 5.9 billion.

**Transportation:** Jerusalem light rail, Tel Aviv express lane, Trans-Israel Highway, sections 3 and 7 of the Trans-Israel Highway, Highway 431, Carmel Tunnels – for a total of NIS 14.9 billion.

**Desalination plants:** Three active plants in Ashkelon and Hadera and at Palmachim, and another two plants under construction at Sorek and in Ashdod – for a total of NIS 7.5 billion. By the end of 2013 desalinated water will account for at least 70% of drinking water in the State of Israel.

Below are details of the main developments in 2012 and 2013 in the projects that are being advanced:

#### **Construction**

Israel Police National Training Center – In 2012 the financial closing was completed and construction of the facility began, to continue until 2015.

National Archive in Arad – The deadline for bid submissions in the tender was at the end of 2012.

Hospital in Ashdod – The project is in the construction stage.

Wholesale market – The market will be located in the vicinity of the Mesubim Junction. In 2012 it was decided to implement the project by the PPP method. In the course of 2013 a prequalification process will be held and the tender documents are expected to be published.

#### **Energy:**

Plot A solar thermal power plant – Bids for the tender were submitted in 2012.

Plot B solar thermal power plant – In December 2012 a BOT agreement was signed with the winner in the tender. The financial closing and the start of construction are planned for 2013.

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- Photovoltaic power plant – In March 2012 a BOT agreement was signed with the winner in the tender. The financial closing and the start of construction are planned for 2013.
- Municipal organic waste treatment plant using advanced methods and producing "green energy" – In October 2012 the prequalification process was announced. The submission and examination of bids in the prequalification process and publication of the tender documents are planned for 2013.

**Transportation:**

- Jerusalem light rail, Tel Aviv express lane, Trans-Israel Highway, Highway 431 and the Carmel Tunnels are all in the operation stage.
- Sections 3 and 7 of the Trans-Israel Highway – Bids were submitted in the tender, and the winner is expected to be chosen in 2013, when an agreement will be signed with it.

**Seawater desalination:**

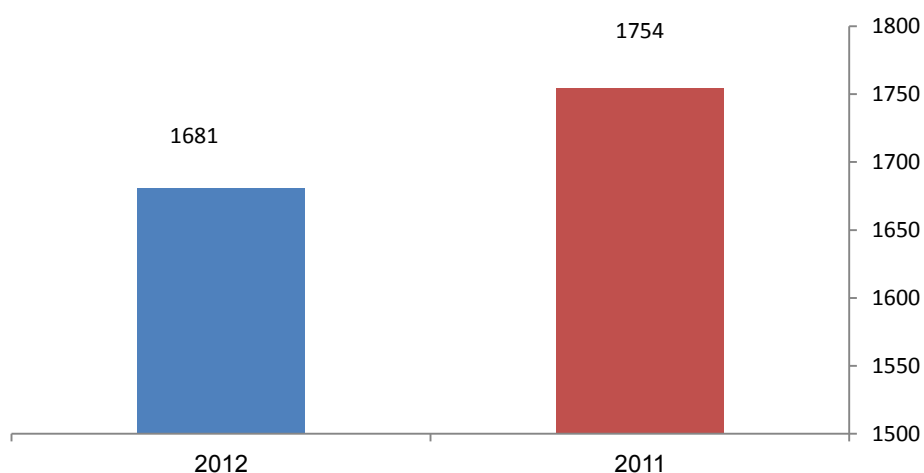
- The desalination plants in Ashkelon and Hadera and at Palmachim are in the operation stage. The desalination plant in Ashkelon produces more than 115 cubic meters of water in a year, while the Hadera plant produces 127 million cubic meters. At the beginning of 2013 the first stage of expansion of the desalination plant at Palmachim was completed, so that by the end of 2012 it will produce 90 million cubic meters of water a year instead of 45 million cubic meters.
- The desalination plants at Sorek (150 million cu m.) and in Ashdod (100 million cu m.) in 2012 and 2013 are in the process of construction which should be completed towards the end of 2013.

## 8. REVENUE FROM ROYALTIES

The Government has a right to receive royalties or other economic benefits arising from the grant of concessions and licenses to concessionaires and from assistance in R&D programs which are supported by the Chief Scientist in the Ministry of Industry, Trade and Labor ("royalty arrangements"). It should be noted that royalties derived from assistance in R&D programs are not presented in the financial statements as current revenue but as the write-down of assets (see note 9A). These royalty arrangements may exist pursuant to laws, regulations, administrative decisions, agreements, arrangements, etc. Revenue from royalties is attributable mainly to concessions granted for the extraction of natural resources (e.g.: production of oil and natural gas, mining of potash, phosphates, gravel and sand, etc.), R&D programs supported by the Chief Scientist and the grant of licenses to media concessionaires. The royalties to which the Government is entitled are usually calculated as a percentage of the revenue (sometimes net of certain expenses) from sales of the natural resources/products developed by the concessionaires/supported companies to third parties. It is important to note that revenue from royalties in the different government ministries is not distributed linearly, and the royalty percentage paid by the different companies/entities is derived from profits/sales in a given period. Furthermore, royalty arrangements set by virtue of laws, regulations and decisions can change from time to time.

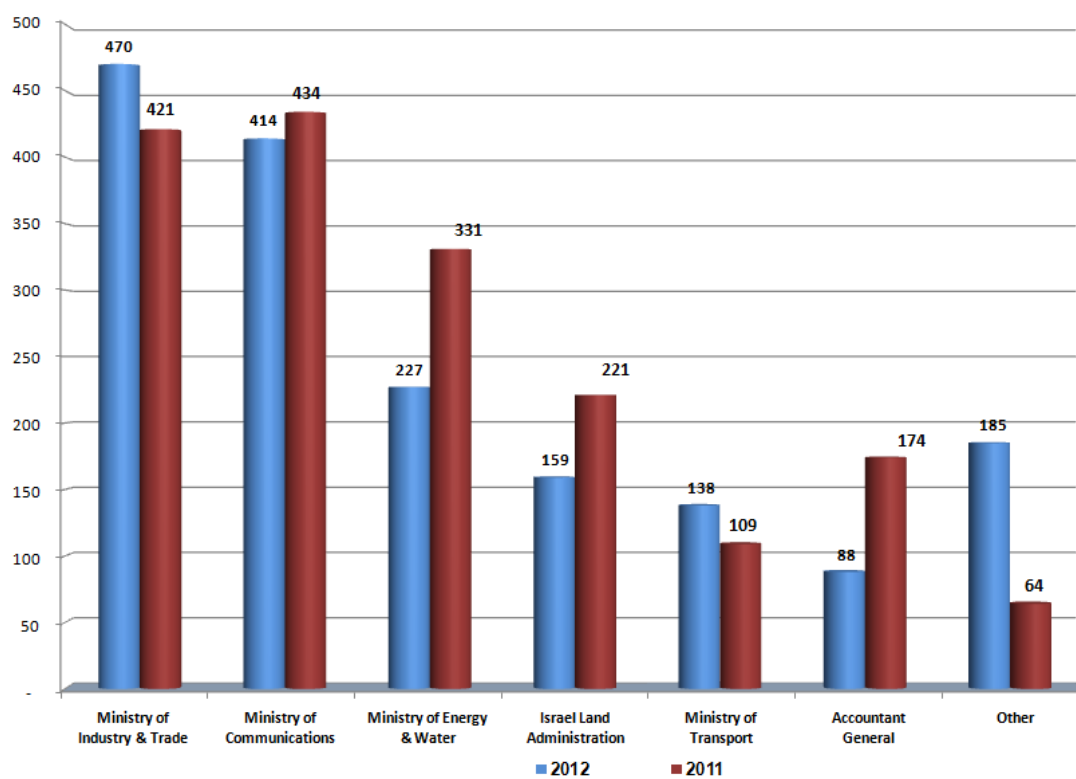
In the framework of the control on royalties, an Administrative Code directive was issued regarding Revenue from Royalties – Recording, Reporting and Control.

**Diagram 1 – Annual comparison – Government revenue from royalties, 2011-2012 (Million NIS)**



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**Diagram 2 – Inter-ministerial comparison – State income from royalties in 2011-2012 (Million NIS)**



**Following is an analysis of the main differences compared to the previous year:**

The State's total revenue from royalties for January-December 2012 was lower by NIS 73 million (down 4%) than in the same period last year.

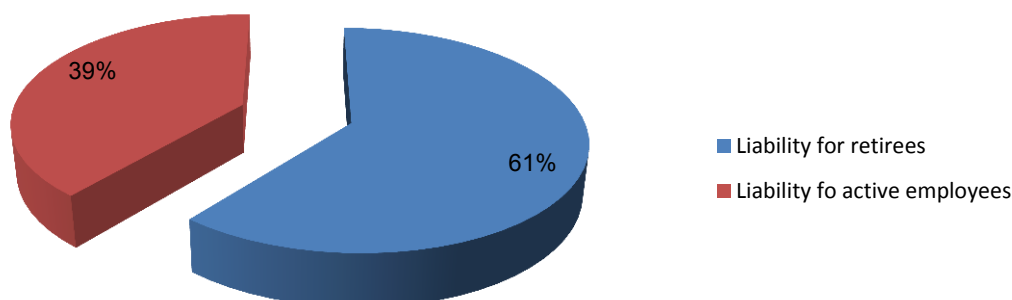
- **Ministry of Industry, Trade and Labor** – The ministry's revenue in 2012 was higher by NIS 49 million than in the same period last year. The difference is due primarily to an increase of NIS 50 million in royalties paid by the Dead Sea Works. According to a blueprint agreed upon between the Government of Israel and the Dead Sea Works, starting from 2012, royalties from the latter on sales beyond a quantity of 1.5 million tons of potassium chloride are to be increased to 10%. Royalties as stated were paid in 2010 and 2011 beyond sales of 3 million tons a year.
- **Energy and Water Ministry** – The ministry's revenue in 2012 was lower by NIS 104 million than in the same period last year. The difference is due primarily to increased consumption in 2011 of natural gas produced from the Yam Tethys reserve, which caused the wells to collapse, resulting in low consumption in 2012 and a commensurate reduction in royalties.
- **Accountant General Division** – The Accountant General's revenue in 2012 was lower by NIS 86 million than in the same period last year. The difference is due primarily to the recording of one-time revenue of NIS 140 million in the previous year in respect of royalties from the grant of a concession for the Tel Aviv express lane.
- **Israel Land Administration** – The administration's revenue in 2012 was lower by NIS 62 million than in the same period last year. The difference is due primarily to the sale of three sand quarries for long-term mining (NIS 50 million in 2011).
- **Other** – Revenue of the Ministry of Defense was higher by NIS 121 million than in the same period last year (NIS 178 million in 2012 versus 57 million in 2011).

## 9. LIABILITIES FOR BUDGETARY PENSION

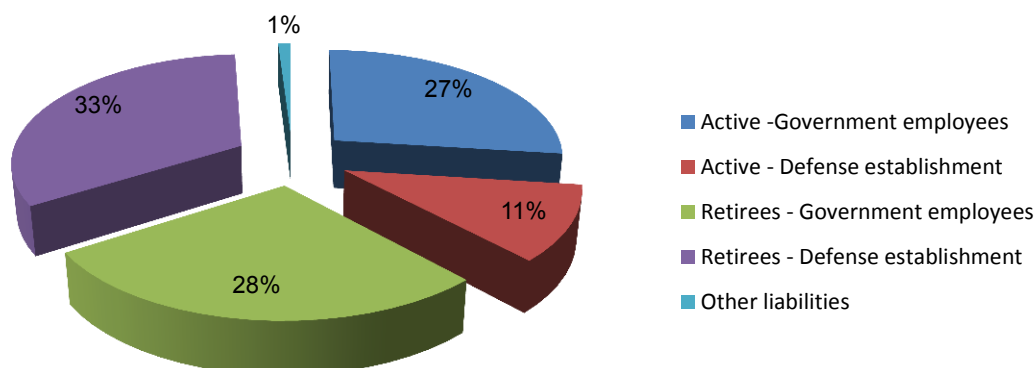
A government employee whose employment commenced before 2002 (2004 for defense entities) is entitled to a budgetary pension paid from the State's current budget, pursuant to the following laws: State Service (Pensions) Law [Consolidated Version], 5730-1970, Permanent Service in the Israel Defense Forces (Pensions) Law [Consolidated Version], 5745-1983, and the Pensions for Officers in Government Authorities Law, 5729-1969. The State's pension liability for retirees, active employees and the survivors of those entitled to pensions amounted as of December 31, 2012 to NIS 572 billion, based on the actuarial calculation set out in note 18 to the consolidated financial statements of the State of Israel.

The diagrams below show the State's actuarial liability broken down according to active employees and retirees, with a further breakdown according to active employees and retirees of the government and the defense establishment (including survivors who are entitled by law to a pension).

**Actuarial Liability - NIS 572 Billion**

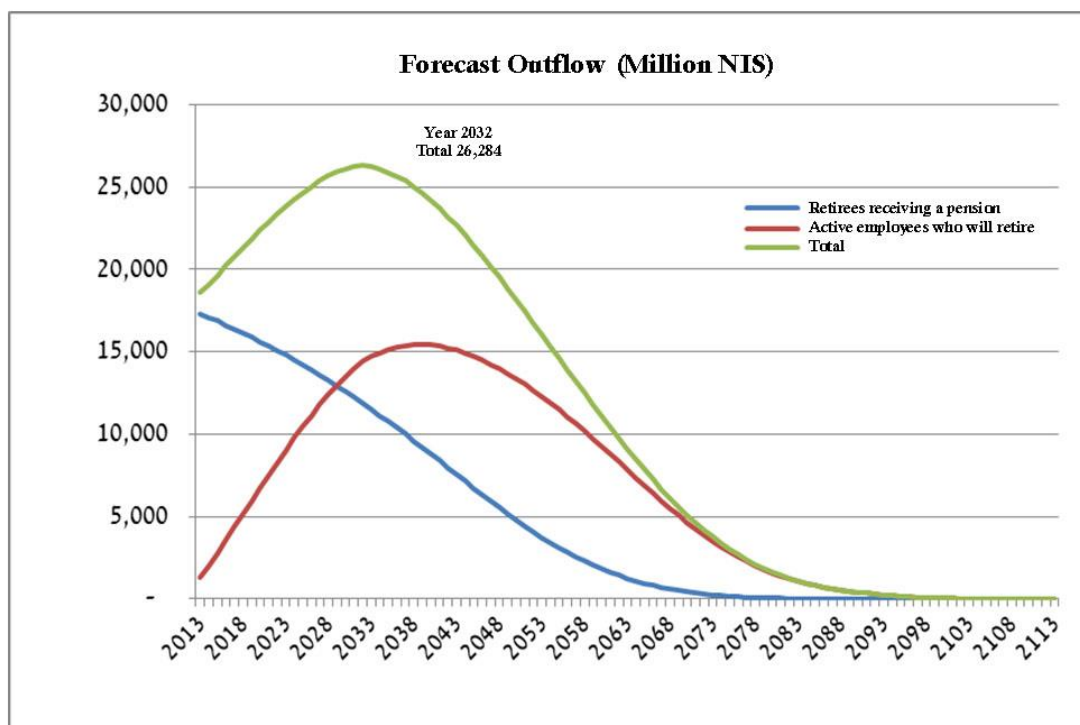


**Actuarial Liability**





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\* Appendix E to the financial statements provides a breakdown by years and amounts of the expected outflow in respect of the full budgetary pension liability.

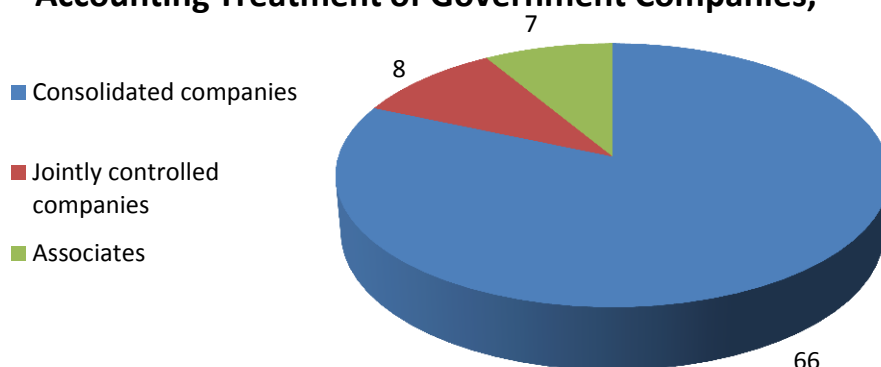
The actuarial liability is an estimate based on the method, data and assumptions as aforesaid. The Government's exact pension liability will become known only upon the death of the employee or the retiree or their survivor who is the last insured. Until then, it is possible merely to estimate the liability by means of basic assumptions as to future events not certain to happen which could affect the amount of the pensions that will be paid, the starting date for the payment of any future pension and the duration of payment of each pension. These assumptions are reviewed from time to time and updated based on current data and studies.

## 10. GOVERNMENT COMPANIES

### Investment in Government Companies

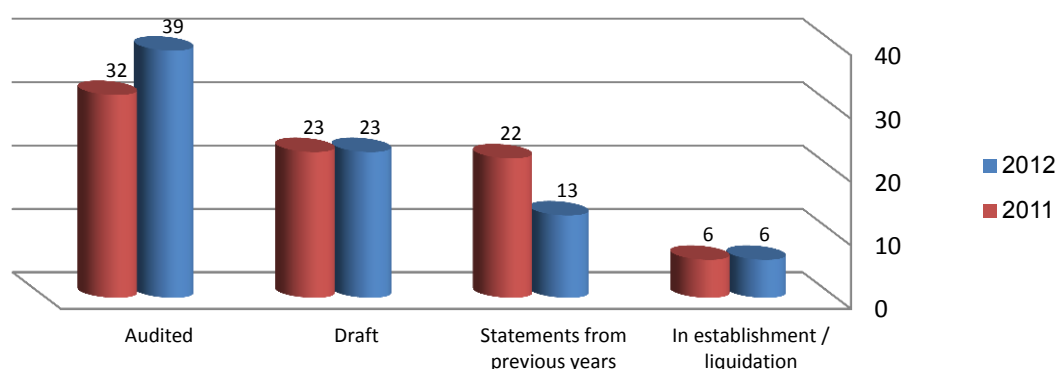
The Government of Israel acts to promote its socioeconomic policy also through investments in government companies and mixed companies, as these terms are defined in the Government Companies Law, 5735-1975 ("the Companies Law"). The activity of the government companies has a significant impact on the economy and on the supply of public services in the areas of infrastructure, construction, electricity, water and so forth. At present there are 81 government companies, of which the major ones are: Israel Electric Corporation, Israel Aeronautic Industries, Mekorot Water Company, Israel Military Industries, Rafael Armament Development Authority, the port companies and Israel Railways, among others. The government companies are under the supervision of the Government Companies Authority, which also advises the companies, the ministerial committees and the government ministries on the management of the companies' business and deals with matters related to privatization, liquidation and the establishment of new companies.

### Accounting Treatment of Government Companies,



The financial data of the government companies included in the consolidated financial statements of the Government of Israel ("consolidated statements") are based on the companies' audited financial statements as of the date of the consolidated statements. In cases where audited financial statements were not received on time, the financial data are based on draft financial statements as of then or on audited/draft financial statements for earlier periods.

### Reports of Government Companies 2011- 2012



## 11. GOVERNMENT DISBURSEMENTS

### Government Disbursements

The "Government Disbursement Data" publication presents government disbursement transactions<sup>1</sup> (excluding net civil service payroll and pension payments) carried out by the Accounting Unit in the Accountant General Department. The data are shown according to various profiles, including a 2012-over-2011 comparison as well as selected statistical data, and are meant to serve as a tool for optimal planning of government payments by the government as a whole and by each government ministry.

### Following are key data:

**Disbursements in 2012 totaled NIS 323 billion compared to NIS 301 billion in 2011 (a 7% increase).** Disbursements through the Merkava system amounted to NIS 307 billion and through the Bohan system to NIS 16 billion, compared to NIS 281 billion and NIS 20 billion, respectively, in 2011.

**Monthly disbursements grew substantially in March, May, June, July and August 2012 compared to 2011.** The growth is attributable mainly to increased national debt payments in those months compared to the previous year. In contrast, the volume of payments decreased in **November and December** due to lower national debt payments in those months than the year before. **See Diagram 1.**

**Government debt payments account for 29% of total annual disbursements.** A breakdown of these payments shows a high variance between, and within, the different months that significantly impacts overall government disbursement data. The monthly average stands at NIS 7.9 billion, with a monthly standard deviation of NIS 4.4 billion. **See Diagram 2.**

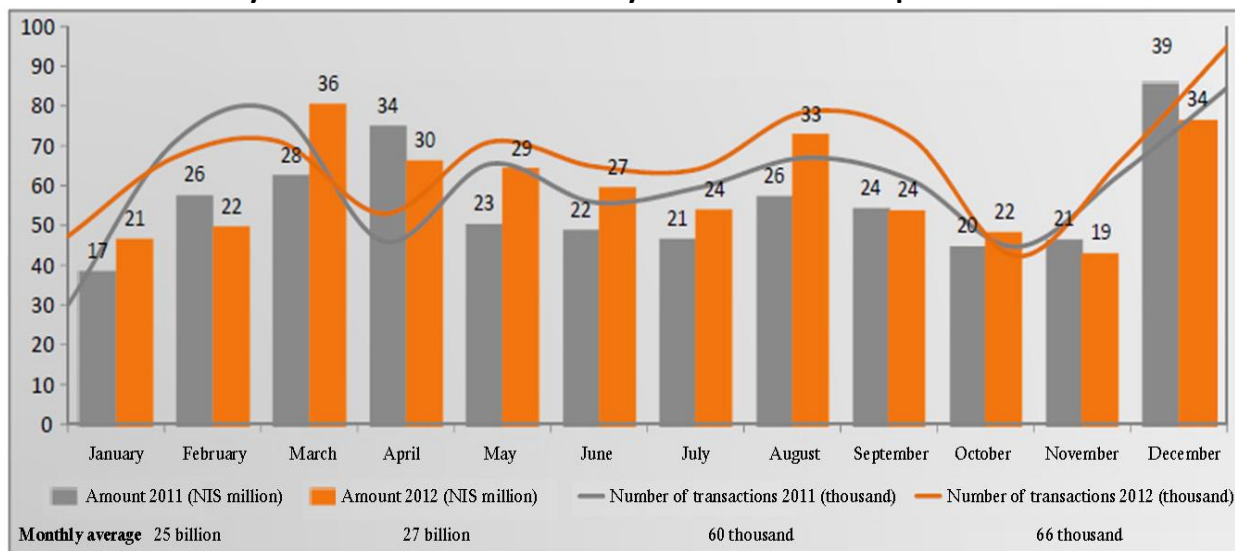
**Monthly payments by government ministries (according to disbursement dates, net of government debt payments)** were in the range of NIS 17-22 billion, apart from January and October, which recorded the lowest disbursements at NIS 13 billion and NIS 12 billion, respectively (opening of the budget year and the Jewish High Holiday period, respectively), and the month of December, which had the highest disbursements at more than NIS 32 billion (end of the budget year), representing a gap of 170% compared to the monthly average.

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<sup>1</sup> Computerized transfer of payroll and other payments (payments to suppliers, etc.) from the payor to the beneficiary's bank account by electronic fund transfer (EFT).

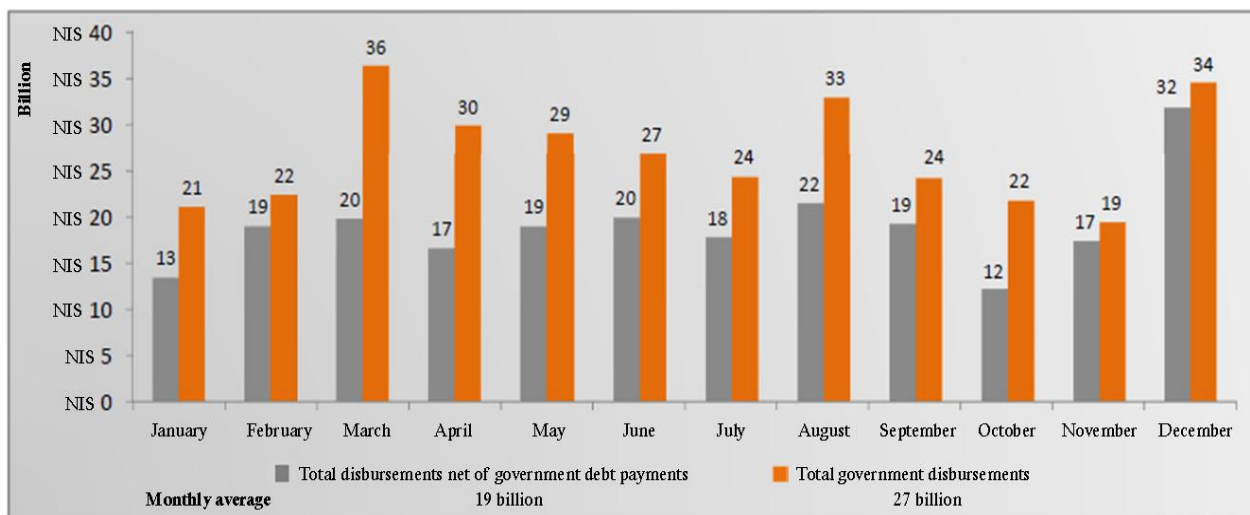
**Diagram 1**

**Monthly Disbursements –  
 Monetary Amount and Number of Payments in 2012 Compared to 2011**



**Diagram 2**

**Monthly Disbursements – Including and Net of Government Debt Payments**



**PART B**

**GOVERNMENT OF THE STATE  
OF ISRAEL  
ESSENCE OF FINANCIAL  
STATEMENTS**

**AS OF DECEMBER 31 2012  
(UNAUDITED)**

State of Israel  
Ministry of Finance – Accountant General  
Government of Israel – Financial Statements as of December 31 2012

STATEMENTS OF FINANCIAL POSITION (NIS MILLIONS)

	Note	Consolidated (*)		Government of Israel	
		December 31		December 31	
		2012	2011 (**)	2012	2011 (**)
<b>Current assets:</b>					
Cash and cash equivalents	3(a)	26,772	23,205	14,426	11,302
Long-term deposits and investments	4	11,285	9,582	2,227	1,760
Current maturities in respect of long-term loans	5(a)	3,561	3,661	6,602	6,194
Accounts receivable	6	53,520	53,901	32,569	33,794
Current inventory	7	7,229	6,378	941	807
<b>Total current assets</b>		<b>102,367</b>	<b>96,727</b>	<b>56,765</b>	<b>53,857</b>
<b>Non-current assets:</b>					
Long-term loans	5(b)	25,280	29,054	25,280	29,054
Investments in investees (companies and entities)	8(a)	3,205	3,345	70,453	69,073
Receivables in respect of royalties	9(a)	7,233	6,827	7,233	6,827
Other financial assets	10	25,153	22,485	5,759	4,958
Non-current inventories	7	1,198	1,216	1,015	1,097
Investment in public private partnerships (PPP)	11	21,056	19,236	21,056	19,236
Property plant and equipment	12(a)	304,136	294,347	188,817	183,709
Intangible assets	13	2,478	2,304	573	540
<b>Total non-current assets</b>		<b>389,739</b>	<b>378,814</b>	<b>320,186</b>	<b>314,494</b>
<b>Total assets</b>		<b>492,106</b>	<b>475,541</b>	<b>376,951</b>	<b>368,351</b>
Contingent assets in respect of royalties from natural resources	9(b)				
State-owned lands	12(b)				

(\*) Consolidated data for the Government of Israel, the National Insurance Institute and government companies

(\*\*) Restated

**The assets presented in this statement do not represent the overall assets of the State of Israel, but only part of them.**

**The list of Government assets presented in this statement do not yet include a large number of assets the value or cost of which is highly material, such as some infrastructure assets, State investments in the defense sector, State-owned lands, all heritage assets, some of the assets abroad and the majority of intangible assets.**

The notes to the financial statements constitute an integral part thereof.

State of Israel  
Ministry of Finance – Accountant General  
Government of Israel – Financial Statements as of December 31 2012

## STATEMENTS OF FINANCIAL POSITION (NIS MILLIONS)

	Note	Consolidated (*)		Government of Israel	
		December 31		December 31	
		2012	2011 (**)	2012	2011 (**)
<b>Current liabilities:</b>					
Short-term credit	3(b)	6,004	1,431	215	172
Domestic loans – current maturities	14	85,341	89,122	78,951	83,559
Foreign loans – current maturities	15	15,686	16,695	15,585	16,703
Accounts payable and accruals	16	47,511	45,413	16,059	13,014
<b>Total current liabilities</b>		<b>154,542</b>	<b>152,661</b>	<b>110,810</b>	<b>113,448</b>
<b>Non-current liabilities:</b>					
Domestic loans – less current maturities	14	528,200	478,548	662,170	608,355
Foreign loans – less current maturities	15	104,547	106,477	90,325	93,129
Provision for losses of investees	8(b)	-	-	273,670	222,457
Provision for support of pension funds	17	122,898	118,241	122,898	118,241
Liabilities in respect of employee benefits	18	593,123	579,043	580,812	567,699
Reserves for insurance events	19	440,748	383,286	4,277	3,910
Provision for lawsuits	20	5,881	6,541	5,057	5,580
Other long-term liabilities	21	32,042	32,782	17,139	17,909
Liabilities for Public Private Partnerships	11	19,830	18,709	19,830	18,709
<b>Total non-current liabilities</b>		<b>1,847,269</b>	<b>1,723,627</b>	<b>1,776,178</b>	<b>1,655,989</b>
<b>Total liabilities</b>		<b>2,001,811</b>	<b>1,876,288</b>	<b>1,886,988</b>	<b>1,769,437</b>
State guarantees	22				
Contingent liabilities	23				
<b>Net assets/equity (net liabilities/capital deficiency):</b>					
Attributable to the Government of Israel		(1,510,037)	(1,401,086)	(1,510,037)	(1,401,086)
Attributable to non-controlling interests		332	339	-	-
<b>Total net liabilities/ capital deficiency</b>		<b>(1,509,705)</b>	<b>(1,400,747)</b>	<b>(1,510,037)</b>	<b>(1,401,086)</b>
<b>Total liabilities and capital deficiency</b>		<b>492,106</b>	<b>475,541</b>	<b>376,951</b>	<b>368,351</b>

(\*) Consolidated data for the Government of Israel, the National Insurance Institute and government companies

(\*\*) Restated

**The capital deficiency is a residual number which does not represent the cumulative Government deficit, since the assets are not presented in full in the financial statements. For further information regarding this issue, please see the Preface to the Financial Statements and their Notes.**

Uzi Sher, CPA  
Chief Accountant

Michal Abadi-Boiangiu, CPA  
Accountant General

May 30, 2013  
Date of approval of  
the financial statements

State of Israel  
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The notes to the financial statements constitute an integral part thereof.

STATEMENTS OF FINANCIAL PERFORMANCE (NIS MILLIONS)

	Notes	Consolidated (*)		Government of Israel	
		For the year ended		For the year ended	
		December 31		December 31	
		2012	2011 (**)	2012	2011 (**)
<b>Revenues</b>					
Revenues from taxes and fees	24	268,579	262,694	236,414	231,148
Revenues from transfers	25	13,060	11,406	13,014	11,362
<b>Total revenue from non-exchange transactions</b>		<b>281,639</b>	<b>274,100</b>	<b>249,428</b>	<b>242,510</b>
Revenue from goods sold and services rendered	26	66,723	63,033	14,444	13,916
Passive revenues	27	9,010	12,802	9,273	12,980
<b>Total revenues from exchange transactions</b>		<b>75,733</b>	<b>75,835</b>	<b>23,717</b>	<b>26,896</b>
Other revenues	28	7,771	7,279	7,154	6,895
<b>Total revenues</b>		<b>365,143</b>	<b>357,214</b>	<b>280,299</b>	<b>276,301</b>
<b>Expenses</b>					
Payroll and employee benefits	29	112,451	126,399	93,748	110,972
Appropriations, allocations and transfers	30	223,041	193,713	132,439	135,487
Operating expenses	31	98,933	92,392	66,847	61,822
Marketing and public relations	32	1,780	1,900	1,046	1,162
Administrative and general expenses	33	4,100	5,295	3,290	4,440
Financing expenses, net	34	36,601	44,823	44,413	53,797
Other expenses		1,976	3,307	1,248	1,215
<b>Total expenses</b>		<b>478,882</b>	<b>467,829</b>	<b>343,031</b>	<b>368,895</b>
Share of profits (losses) of investee companies and entities	8	121	102	(50,878)	17,920
<b>Net deficit</b>		<b>(113,618)</b>	<b>(110,513)</b>	<b>(113,610)</b>	<b>(110,514)</b>
<b>Attributable to:</b>					
The Government of Israel		(113,610)	110,514	(113,610)	(110,514)
Non-controlling interests		(8)	1	-	-
<b>Net deficit</b>		<b>(113,618)</b>	<b>(110,513)</b>	<b>(113,610)</b>	<b>(110,514)</b>

(\*) Consolidated: the Government of Israel, the National Insurance Institute and government companies

(\*\*) Restated

The statements of financial performance are not fully accrual-based, as some of the Government ministries still report their data on a cash basis, and some do not process their financial data using an enterprise accounting and reporting system. Therefore, the statement of financial performance is based, among others, on data from auxiliary systems used alongside the main accounting system, as well as on extensive use of assessments and estimates.

The net accounting deficit does not reflect the Government of Israel's budget deficit, as it is calculated using different measurement tools which are based on accrual-basis. These principles express changes in assets and liabilities which do not necessarily involve cash flow and which are not fully reflected in the State Budget, in accordance with the Budget Foundations Law and with the budget deficit measurement method common around the world. The net accounting deficit includes expenses that are currently accounted for but which will only materialize as cash expenses and budgetary charges in the future.



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The notes to the financial statements constitute an integral part thereof.

STATEMENTS OF CHANGES IN NET ASSETS/ EQUITY (NIS MILLIONS)

**GOVERNMENT OF ISRAEL/CONSOLIDATED**

	Note	Balance as of Dec 31 2011(*)	Changes in net assets (**)	Net deficit for the period	Balance as of Dec 31 2012	Attributable to the government	Attributable to non- controlling interests
<b>Accumulated deficit</b>		<b>(1,406,746)</b>	2,712	(113,618)	<b>(1,517,652)</b>	(1,517,984)	332
<u>Non-budgetary capital reserves</u>							
State guarantees fund	35(b)	<b>1,082</b>	434	-	<b>1,516</b>	1,516	-
Compensation fund (property tax)	35(c)	<b>3,556</b>	1,041	-	<b>4,597</b>	4,597	-
Internal Government Insurance Fund	35(γ)	<b>1,043</b>	62	-	<b>1,105</b>	1,105	-
Fund profits tax on oil		<b>129</b>	106	-	<b>235</b>	235	-
Other capital reserves	35	<b>189</b>	305	-	<b>494</b>	494	-
<b>Total non-budgetary capital reserves</b>		<b>5,999</b>	1,948	-	<b>7,947</b>	7,947	-
<b>Total net liabilities</b>		<b>(1,400,747)</b>	<b>4,660</b>	<b>(113,618)</b>	<b>(1,509,705)</b>	<b>(1,510,037)</b>	<b>332</b>

(\*) Restated

(\*\*) Including from designated surplus, from cumulative effect for the beginning of the year as a result of asset recognition, change of accounting methods, and revaluation of assets and liabilities.

**The capital deficiency is a residual number which does not represent the cumulative Government deficit, since the assets are not presented in full in the financial statements. For further information regarding this issue, please see the Preface to the Financial Statements and their Notes.**

The notes to the financial statements constitute an integral part thereof.

## NOTES TO THE FINANCIAL STATEMENTS AS OF DECEMBER 31, 2012

### NOTE 1 – GENERAL:

- A. The Government of Israel's financial statements as of December 31, 2012, are filed in accordance with Section 12 of the State Comptroller Law of 1958 [Consolidated Version] and in accordance with Section 49a of the Budget Foundations Law of 1985.
- B. The Government of Israel's financial statements (henceforth – the individual financial data) present the activities, financial position and financial performance of three authorities: the legislative authority, the executive branch and the judicial branch. The consolidated financial statements include, in addition to the individual financial data, the financial data of Government companies and Statutory Corporations. As of the date of the financial statements, the statutory corporations include only the financial data of the National Insurance Institution. A concise description of components of the consolidated financial statements follows (for extensive details see part C of the financial statements):
- (1) **The legislative authority** – The Knesset is the State's legislative authority and the parliament of the State of Israel. The Knesset has three additional key roles: supervising the Government's work, electing the President of Israel and the State Comptroller, and consideration of State matters through the Knesset Committees and Plenum. There are 12 permanent committees in the Knesset that address matters such as finance, foreign relations and security, constitution, law and justice, etc. These committees discuss legislative proposals, regulations set by the Government, proposals for the daily agenda and requests submitted to the Knesset and Government by residents.
  - (2) **The executive branch** – The Government of Israel is the executive branch of the State of Israel. Heading the Government is the Prime Minister, and its members are ministers who are in charge of the various ministries. The Government of Israel retains authority in most national and public aspects, and represents the State of Israel internationally.
  - (3) **The judicial branch** - The judicial branch in Israel consists of law courts and tribunals which are vested with judicial power by the Basic Law: The Judiciary. The law courts have general jurisdiction over criminal, civil and administrative matters, while the jurisdiction of the tribunals is limited to specific matters or persons. The judiciary operates independently of any person or other authority, and the judges enjoy both personal and substantive independence.
  - (4) **Government companies** – Government companies are subject to the Government Companies Law of 1975, and are supervised by the Government Companies Authority, which is responsible for monitoring and supervising these companies, as well as for their privatization and restructuring. Some Government companies constitute controlled entities of the Government of Israel for financial reporting purposes, in accordance with Government Accounting Standard 6 – Consolidated and Separate Financial Statements (Revised 2010). In light of the abovementioned control, the financial statements of Government companies were consolidated in the Government of Israel's consolidated financial statements. For additional information regarding reporting requirements, controls over financial reporting and the accounting policies of Government companies, as well as

**State of Israel**  
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information on the financial statements of Government companies, please visit the Government Companies Authority website, at [www.gca.gov.il](http://www.gca.gov.il).

- (5) **The statutory corporations** – The statutory corporations were established by special legislation which is the source of the authority they work by. In Israel, more than 60 corporations were established for various purposes, with the accounting activity of some of these corporations being separate from that of the Government. The financial statements as of 31 December 2012 include only the financial data of the National Insurance Institution – which is a statutory body established in 1954, and operates under the National Insurance Institute Law (Consolidated Version) of 1995.

**C. The State Comptroller:**

As specified in Part A, the Government of Israel's financial statements are filed according to Article 12 of Law of the State Comptroller.

The State Comptroller is responsible for the independent auditing of the various activities of the State Administration and other public entities, to ensure supervision over public funds and accountability. The State Comptroller examines legality and regularity, savings, efficiency, and moral integrity. The Office of the State Comptroller supervises all government ministries, state institutions, all branches of the defense sector, local authorities and government companies. In addition, the Office has a separate unit headed by the Ombudsman, which is responsible for the protection of citizens from government authorities.

**D. Information systems:**

The financial statements are based on the performance data recorded in the various financial systems of Government ministries and entities, including a comprehensive cross-organizational ERP system for Government offices used for managing organization resources, including finance, logistics and HR (hereinafter – “the Merkava System”), which was implemented in the majority of the Government ministries and entities.

**E. Auditing data:**

Some of the Government ministries were audited by independent auditors. At the same time, it should be noted that some of the information, including the comparative figures presented in the financial statements of the Government of Israel, is primarily based on existing data in information systems, which were used as the source for these financial statements. This information is not audited and may include material deviation from actual results. In addition, the information included in the consolidated financial statements is to a large extent based on the incomplete reports of government companies as of year-end 2012 or on available quarterly reports for the purpose of consolidation. The audited information of these government companies, once it is published, may be materially different from the information based on which these financial statements were prepared and consolidated.