



GOVERNMENT OF THE STATE OF ISRAEL

CONDENSED FINANCIAL STATEMENTS

AS OF DECEMBER 31 2014
(UNAUDITED)

State of Israel
Ministry of Finance – Accountant General
Government of Israel – Financial Statements as of December 31 2014



ACCOUNTANT GENERAL
MINISTRY OF FINANCE
STATE OF ISRAEL

July 05, 2015

To
The Users of the Financial Statements,

I am honored to present the consolidated financial statements of the Government of the State of Israel for the year ended December 31, 2014. The financial statements are prepared in accordance with generally accepted accounting standards, as described in note 2 to the financial statements - Significant Accounting Policies.

The Government of Israel is in the process of completing a substantive reform on government accounting, primarily gradual adoption of government accounting standards based on international standards for the public sector (IPSAS), management accounting of state assets and liabilities, while migrating accounting reporting from cash basis to accrual basis accounting, as well increasing the reliability of financial reporting through external audit of the financial statements. The reform poses many challenges, but is expected to significantly improve the quality of financial reporting of the Israeli government, government decision-making, management of state assets and the position of the government among governments in the western world. This reform will provide reliable and complete information on the financial statements of the Israeli government, in the belief that transparency is a cornerstone of proper and efficient administration.

In addition to consolidated and separate financial statements prepared in accordance with GAAP, the financial statements include information regarding present government activities and forward-looking information. The type of information provided gives users a broader picture and greatly expands the scope of users of financial statements.

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 headed by Mr Uzi Sher, senior deputy to the Accountant General, the chief accountants and comptrollers of the Government ministries, the Government Companies Authority and the Chief Financial Officers of government companies and to the Statutory corporations that are consolidated-in the financial statements.

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 2014
(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, upon 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 along with 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. This reform aims to provide the general public, decision makers, and other users of the financial statements with reliable and comprehensive information regarding 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 Department in the past few years.

Independent auditing of financial statement data

The Government of Israel's consolidated financial statements for 2014 are unaudited. However, the Accountant General Department 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 2013 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, and amongst them a significant part of the State's investment in the defense sector and State land (in note 12B to the financial statements disclosure is given regarding the estimated value of the state land).

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Furthermore, it should be noted that the information regarding the Government of Israel's assets and liabilities is not based in its entirety 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 Department 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 generally accepted accounting 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 only materialize following each employee's retirement and will 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 CONTENTS:

The consolidated financial statements of the Government of the State of Israel include the activities, Financial Position and Financial Performance of more than 150 entities, Government ministries, Government Companies and non-commercial statutory corporations.

3. MAIN DIFFERENCES AS COMPARED WITH FINANCIAL STATEMENT DATA FOR THE 2013 FISCAL YEAR

The framework of steps which will lead to significant improvements in reporting quality, include the key changes for fiscal year 2014 compared with Previous year, as follows:

a. Improvement of the quality and reliability of the financial statements

Based on the financial statements for December 31 2014, 60 government ministries and divisions had appointed external auditors (out of 84 Government ministries and divisions), whose budgets account for approximately 78% of the total budgeted expenses of Government ministries.

The independent auditing of financial statements for Government ministries was significantly enhanced, 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.

b. Financial data from the consolidated financial statements attributed to the Government of Israel

This is the first year that the financial statements include a separate section for the separate financial data from the consolidated financial statements of the Government of Israel as of December 31, 2014 ("the separate financial information"). The separate financial information reflects the activities, financial statements and the implementation of the three branches of government: the legislative authority, the executive and the judicial branch. For the list of the entities included in the separate financial information, see Appendix A to the consolidated financial statements.

c. Budget Implementation Reports

This year the budget implementation reports presented 5 years performance data at the level of the ministries, and additional information about accountancy budget performance.

d. Additional Information

This is the first year that the financial statements of the government include presentation of additional information regarding 3 other areas:

- The government's actuarial liabilities payments due to Holocaust survivors population allowances.
- Information regarding subsidies for pension funds
- Review of significant privatization processes according to government long-term plan for privatizations or minority IPO for government companies .

This information will enable readers of the financial statements to get a broader picture regarding the Government's future commitments.

e. Consolidation of government companies

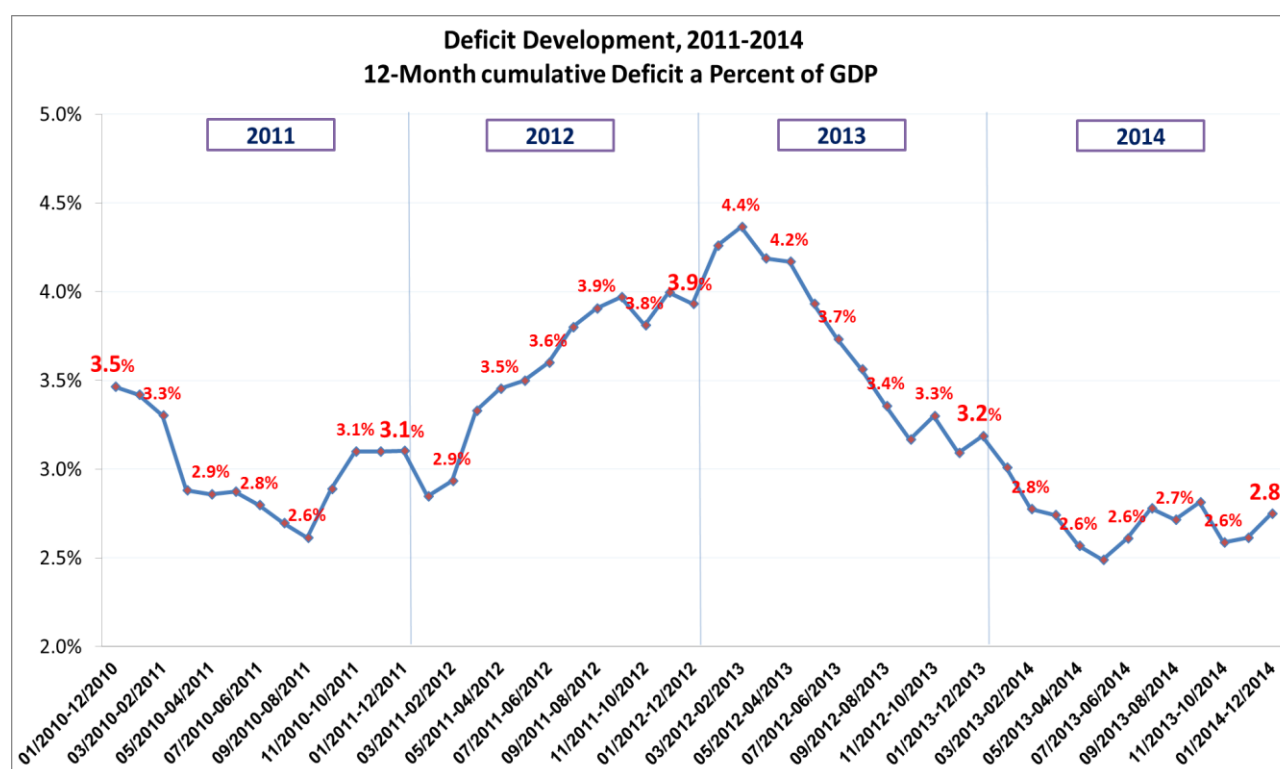
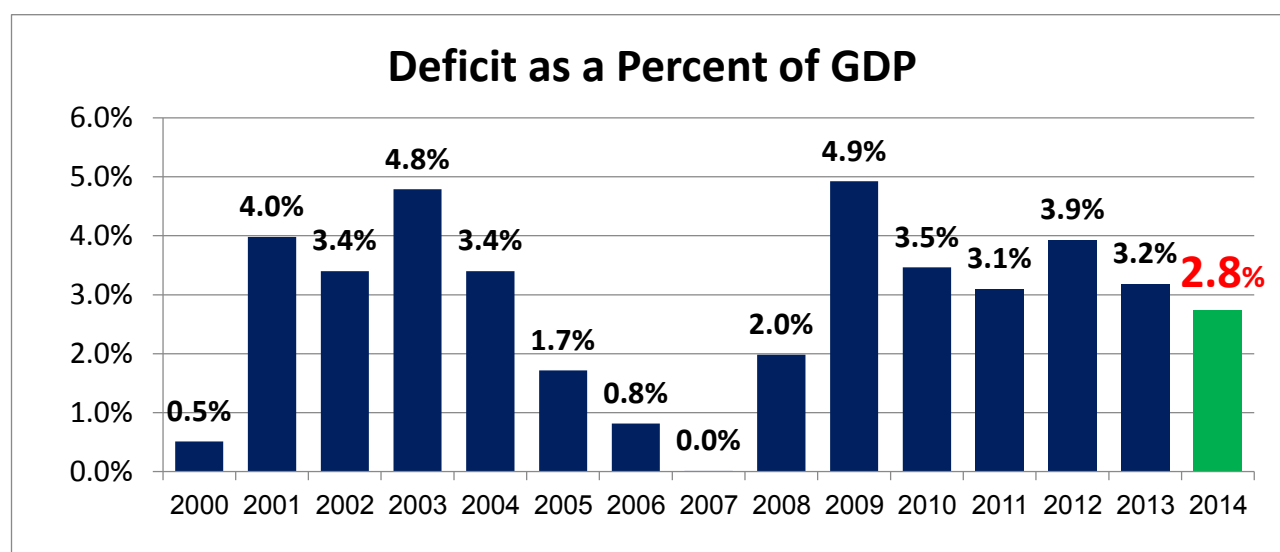
As part of these financial statements, 66 government companies and 2 Statutory Bodies controlled by the Government were consolidated for financial reporting purposes. The presentation of the Government's financial position and financial performance in a consolidated format provides users of financial statements economic information

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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 2014. Therefore, the consolidated data for Government companies is based, sometimes, on unaudited draft financial statements as of December 31 2014, or on interim financial statements for the third quarter of 2014 as well as on annual reports as of December 31, 2013, and/or on drafts of such financial statements as of the above mentioned dates.

4. GOVERNMENT BUDGET DEFICIT FOR 2014

The government budget deficit for 2014 was NIS 29.9 billion, equivalent to 2.8% of GDP, based on an annual GDP of NIS 1,088.5 billion reported by the Central Bureau of Statistics. The original budget for 2014 was planned to include a deficit of NIS 31.1 billion, equivalent to 2.9% of GDP according to the new measurement method of the Central Bureau of Statistics (about 3% of the original budget planning). The main reasons for the deviation from the deficit target were the actual collection of higher tax revenues than the budget forecast and lower expenditure than the original budget planning.



PERENNIAL BUDGET IMPLEMENTATION

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	<u>Perennial implementation (net) million NIS</u>						<u>The rate of change</u>				
	<u>2014</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>/ 2014</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>/ 2010</u>
							<u>2013</u>	<u>/2012</u>	<u>/2011</u>	<u>/2010</u>	<u>2009</u>
President of the State of Israel	56	48	50	46	45	41	17%	(4%)	9%	2%	10%
Knesset	760	863	758	632	559	807	(12%)	14%	20%	13%	(31%)
Prime Minister	2,610	2,559	2,812	2,428	2,109	2,090	2%	(9%)	16%	15%	1%
Finance	5,943	5,175	4,892	4,660	4,443	4,071	15%	6%	5%	5%	9%
Interior	1,169	1,209	873	838	666	608	(3%)	38%	4%	26%	10%
Public security	14,093	13,215	12,158	11,000	10,260	9,692	7%	9%	11%	7%	6%
Justice	3,082	2,924	2,846	2,650	2,556	2,167	5%	3%	7%	4%	18%
Foreign	1,616	1,641	1,664	1,586	1,476	1,478	(2%)	(1%)	5%	7%	(0%)
The State comptroller	299	282	273	246	256	229	6%	3%	11%	(4%)	12%
Pensions and Compensation	13,875	14,211	12,851	11,596	11,968	12,869	(2%)	11%	11%	(3%)	(7%)
Science, Culture and Sport	1,291	1,196	1,179	1,062	944	921	8%	1%	11%	13%	2%
Environmental protection	282	311	405	294	271	241	(9%)	(23%)	38%	8%	12%
Total administrative ministries	45,076	43,634	40,761	37,038	35,553	35,214	3%	7%	10%	4%	1%
local authority	3,854	3,880	3,745	4,035	3,857	3,877	(1%)	4%	(7%)	5%	(1%)
Education	45,070	43,849	40,515	36,761	34,192	30,645	3%	8%	10%	8%	12%
Higher education	9,151	9,086	8,197	7,558	7,342	7,263	1%	11%	8%	3%	1%
Social affairs	5,530	5,267	4,897	4,451	4,177	3,727	5%	8%	10%	7%	12%
The National Insurance Institute	29,331	30,078	30,254	28,727	25,716	26,586	(2%)	(1%)	5%	12%	(3%)
Health	26,834	24,235	21,064	19,520	18,931	17,225	11%	15%	8%	3%	10%
Construction and housing	3,035	2,542	3,093	2,422	2,440	3,465	19%	(18%)	28%	(1%)	(30%)
Immigration	1,522	1,351	1,380	1,342	1,295	1,235	13%	(2%)	3%	4%	5%
Total social ministries	124,327	120,288	113,145	104,816	97,950	94,023	3%	6%	8%	7%	4%
Agriculture and rural development	1,314	1,353	1,320	1,132	1,055	1,050	(3%)	2%	17%	7%	0%
Energy and water resources	411	1,094	454	298	270	266	(62%)	141%	52%	10%	2%
Economy	4,935	4,953	4,426	4,376	3,761	4,251	(0%)	12%	1%	16%	(12%)
Tourism	652	550	588	572	497	478	19%	(6%)	3%	15%	4%
Communications	95	58	77	36	57	51	64%	(25%)	114%	(37%)	12%
Transportation	15,610	17,051	14,702	13,653	12,001	11,394	(8%)	16%	8%	14%	5%
Water and sewage	795	919	957	1,066	1,200	877	(13%)	(4%)	(10%)	(11%)	37%
Survey of Israel	94	90	88	69	64	66	4%	2%	28%	8%	(3%)
Total financial ministries	23,906	26,068	22,612	21,202	18,905	18,433	(8%)	15%	7%	12%	3%
Other expenses	2,757	2,093	1,730	1,168	689	633	32%	21%	48%	70%	9%
Total civilian ministries	196,066	192,083	178,248	164,224	153,097	148,303	2%	8%	9%	7%	3%
Defence Establishment	68,156	64,562	62,418	59,038	58,352	56,988	6%	3%	6%	1%	2%
Total ministries expenses	264,222	256,645	240,666	223,262	211,449	205,291	3%	7%	8%	6%	3%

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5. CONDENSED FINANCIAL STATEMENTS DATA

The Government of Israel's financial statements for fiscal year 2014 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 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.

CONDENSED FINANCIAL DATA FOR THE GOVERNMENT OF ISRAEL (NIS BILLIONS)

	<u>Consolidated</u>		<u>Government of Israel</u>	
	For the year ended Dec. 31		For the year ended Dec. 31	
	<u>2014</u>	<u>2013</u>	<u>2014</u>	<u>2013</u>
Financial performance				
Income from taxes and fees	316.5	297.9	280.5	263.5
Income from transfers	13.8	12.5	13.8	12.6
Income from exchange transactions	75.9	76.4	23.8	22.2
Other income	6.0	4.5	5.1	3.8
Total income	<u>412.2</u>	<u>391.3</u>	<u>323.2</u>	<u>302.1</u>
Payroll and employee benefits	180.9	134.3	163.9	117.4
Appropriations, allocations and transfers	234.5	199.5	139.8	138.3
Operating expenses	102.4	103.6	72.7	69.0
Administrative expenses, public relations and other costs	12.1	12.1	8.2	9.6
Financing expenses, net	36.9	30.7	40.0	38.5
Total expenses	<u>566.8</u>	<u>480.2</u>	<u>424.6</u>	<u>372.8</u>
Share of profits (losses) of investees	0.1	0.1	(53.1)	(18.1)
Net accounting deficit (*)	<u>(154.5)</u>	<u>(88.8)</u>	<u>(154.5)</u>	<u>(88.8)</u>
Financial position				
Current assets	107.5	99.5	58.0	52.8
Financial investments and loans	50.2	49.9	117.7	113.1
Property, plant and equipment	336.0	329.1	216.3	211.8
Other assets	8.9	8.8	2.3	2.2
Total assets	<u>502.6</u>	<u>487.3</u>	<u>394.3</u>	<u>379.9</u>
Current liabilities	128.5	149.1	98.5	118.3
Long-term domestic and foreign loans	727.2	676.9	842.3	791.6
Liabilities in respect of employee benefits	672.1	596.8	658.8	584.4
Reserves from insurance events	522.9	465.9	4.0	4.2
Other long-term liabilities	178.6	175.3	517.8	458.6
Total liabilities	<u>2,229.3</u>	<u>2,064.0</u>	<u>2,121.4</u>	<u>1,957.1</u>
Net liabilities / equity deficit (*)	<u>(1,726.7)</u>	<u>(1,576.7)</u>	<u>(1,727.1)</u>	<u>(1,577.2)</u>

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

(**) Restated

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NET ACCOUNTING DEFICIT VS. BUDGET DEFICIT (NIS MILLIONS)

<u>Government of Israel</u>	<u>For the year ended December 31, 2014</u>
Budget deficit (*)	29,925
Employee benefits – actuarial expenses and increase in other provisions less payments	74,359
Losses of investees not expressed in the budget	51,913
Government loans – net financing expenses less cash payments	955
Net changes in the National Insurance Institute loan	3,887
+ Support of pension funds – expenses incurred less payments	1,893
Property plant and equipment – depreciation expenses less cash purchases during the year	(8,378)
Government loans – net financing income less cash proceeds	(564)
Other long-term liabilities	3,844
Debtors of exchange and non-exchange transactions, net	(5,234)
Short-term provisions and eligible balances	2,880
Inventory – purchases this year	(1,545)
Other changes in assets and liabilities	501
Net accounting deficit	154,436

(*) See Part D – Budget Implementation Reports for 2014.

Financial statements – accrual-based

- 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.
- Revenues – recognized when incurred regardless of their collection date.
- Expenses – recognizes when the obligation is established regardless of the date of repayment.

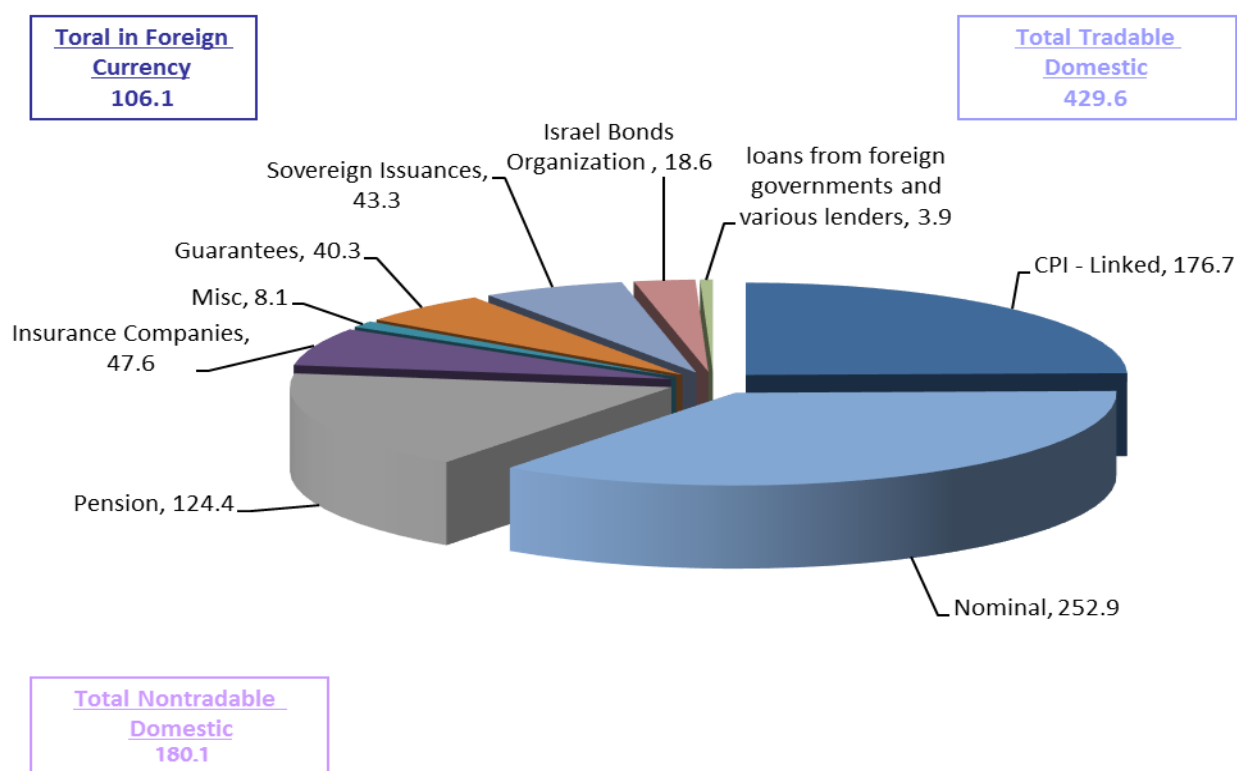
Budget implementation report – cash-based

- 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.
- Proceeds – amounts received in cash such as taxes and fees collected.
- Payments – amounts paid in cash such as pension payments.

6. GOVERNMENT DEBT

Government debt increased in 2014 by 2.8% to NIS 715.8 billion as of December 31, 2014, compared to NIS 696.3 billion as of December 31, 2013. The bulk of the nominal increase in Government debt was due to positive net funding as well devaluation of 12% shekel vs dollar rate. On the opposite side slight decrease in the consumer price index, contributed to lower government debt.

Structure of the Government debt at the end of 2014 (NIS Billions):



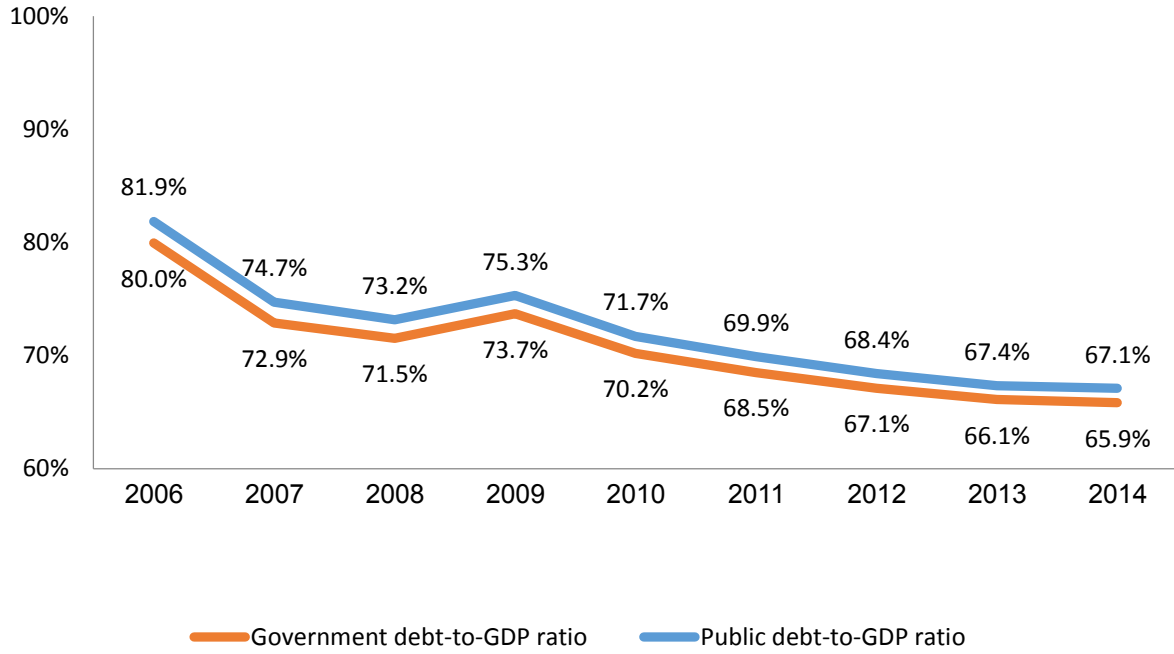
The balance of domestic debt (tradable and non-tradable) stood at NIS 609.7 billion. Tradable debt of NIS 429.6 billion accounted for 70% of total domestic debt. The non-tradable debt increased by 10% and stood at NIS 180.1 billion compared to NIS 163.3 billion in the previous year, constituting approximately 30% of total domestic debt.

The Government's external debt at the end of 2014 was of NIS 106.1 billion, distributed according to the following sectors: US loan guarantee program 38%, sovereign issuances 41%, Israeli Bonds Organization 17%, and the remaining 4% is comprised of foreign government loans and various other loans. The average term to maturity of the total government debt stood at the end of 2014 at 7.4 years, compared to 7.1 years in 2013.

The longer term to maturity stems from the policy of the Accountant General Division to lengthen debt maturity and reduce the refinancing risk, taking advantage of the low interest rate environment.

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 81.9% in 2006 to 67.1% in 2014. Further information can be found on the website of the debt unit in the Financing Division - Accountant General Division - <http://www.ag.mof.gov.il/AccountantGeneral/GovDebt>.

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7. PUBLIC PRIVATE PARTNERSHIP (PPP)

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-ministry 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 output level of the service is dictated and enforced by the State; At the end of the concession period, the project is transferred to the state in good functional condition, at no cost (with the exception of BOO projects in which the state-owned property remains). 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.

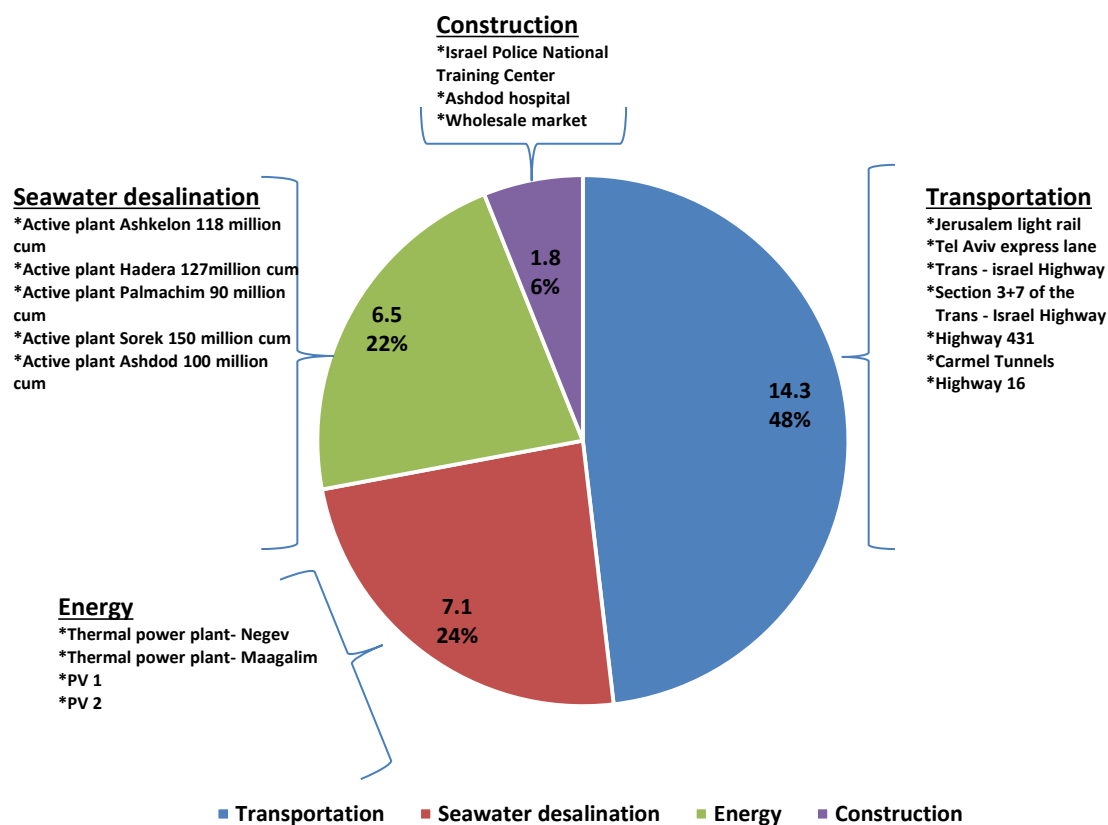
Advantages of PPP projects: improving the level of service to the State and the citizen; shortening timetables; solution for alternative financing by means of various financing entities; cost-saving over the life of the project; generating growth without an increase in the short-term government deficit; 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 according to a structured methodology.

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 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 tender process.

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

Volume of investments in PPP projects by Area (NIS Billion)



***Environment**

Waste treatment facility - Project in auction Stage

Transportation:

Including Jerusalem light rail, Tel Aviv Express lane, Trans-Israel Highway, Trans-Israel Highway north (sections 3 and 7), Highway 431, Carmel Tunnels and Highway 16 - volume totaling NIS 14.3 billion ; the light rail project in Jerusalem, Express lane Tel Aviv, Highway 431 and Highway Carmel Tunnels are currently operational. Transportation projects are - 48% of the total state investment projects that are being carried out by the Division

- Trans-Israel Highway sections 3 and 7 - in February 2014 concession agreement was finalized , and the project is currently in the development stage and before the financial closure. The Highway 16 - tender committee was formed in 2015 in favor of formulating the PQ documents and the tender for the establishment of Highway 16 - Additional access road to Jerusalem from Motza interchange to Byte interchange (near Ramat Beit Hakerem / Shaare Zedek Hospital). Sort early tender published in April 2015. The tender documents are expected to be released in the second half of 2015.

Seawater desalination:

Including four active Seawater desalination plants in Ashkelon, Palmachim, Hadera and at Sorek ,and another plant under construction in Ashdod – for a total of NIS 7.1 billion. The active Seawater desalination plants have a production capacity in excess of 70% of drinking water for domestic use in the State of Israel.

Seawater desalination plants in Ashkelon, Palmachim, Hadera and Sorek – currently in operational stage and Seawater desalination in Ashdod is in construction stage.

Energy:

Including two solar thermal power plants and a photovoltaic power plant at Ashalim – for a total of NIS 6.5 billion.

- Plot A solar thermal power plant - during 2014 the project progressed to the development period. Financial closure and the start of construction are expected in the second quarter of 2015. Completion of the construction period is expected in 2018.
- Plot B solar thermal power plant – Financial closure was in Q3,2014, construction activity has commenced . Plant construction completion is expected in Q3, 2017.
- PV 1 - Photovoltaic power plant – In April 2012 a BOT agreement was signed with the winner of the tender. The financial closure was in December 2013 and the construction period started in 2014. Completion of the construction period is expected in Q3, 2016.
- PV 2 - Photovoltaic power plant – In the first quarter of 2015 a tenders Committee was established in order to promote a PPP tender for financing, construction and operation of an additional PV plant in the Ashalim power station.

Construction

Including the Israel Police National Training Center, Ashdod hospital and a wholesale market – for a total of NIS 1.8 billion

- Israel Police National Training Center – operating period nas part of the construction period and expected to begin operations Wholesale market – Wholesale Market that will replace the temporary market in Zrifin. Is expected to include a computerized trading system to display the prices of commodities. Qrualification stage tender was completed but at this period there was a delay in publication of the main tender in light of disagreements about the project location in the host municipality.

Environment

Organic waste treatment facility - municipal waste treatment facility and advanced methods of organic production "green energy" - following the PQ process, during 2015 tender documents were published and the franchisee will be selected.

PPP projects in the process of feasibility examination:

- Infrastructure tunnels - examining promoting tunnels infrastructure projects in the state.
- Windmills - examination of the publication of a tender were carried out for establishment PPP-based wind power using turbines plants.
- light rail Haifa - Nazareth - promotion examination for project construction of a light railway between Haifa and Nazareth.
- light rail Jerusalem - additional light rail lines in metropolitan area of Jerusalem.
- Construction of eastern drains and brackish desalination plant in the coastal plain.
- Israel Police National Training Center – period 2
- Additional Express lanes

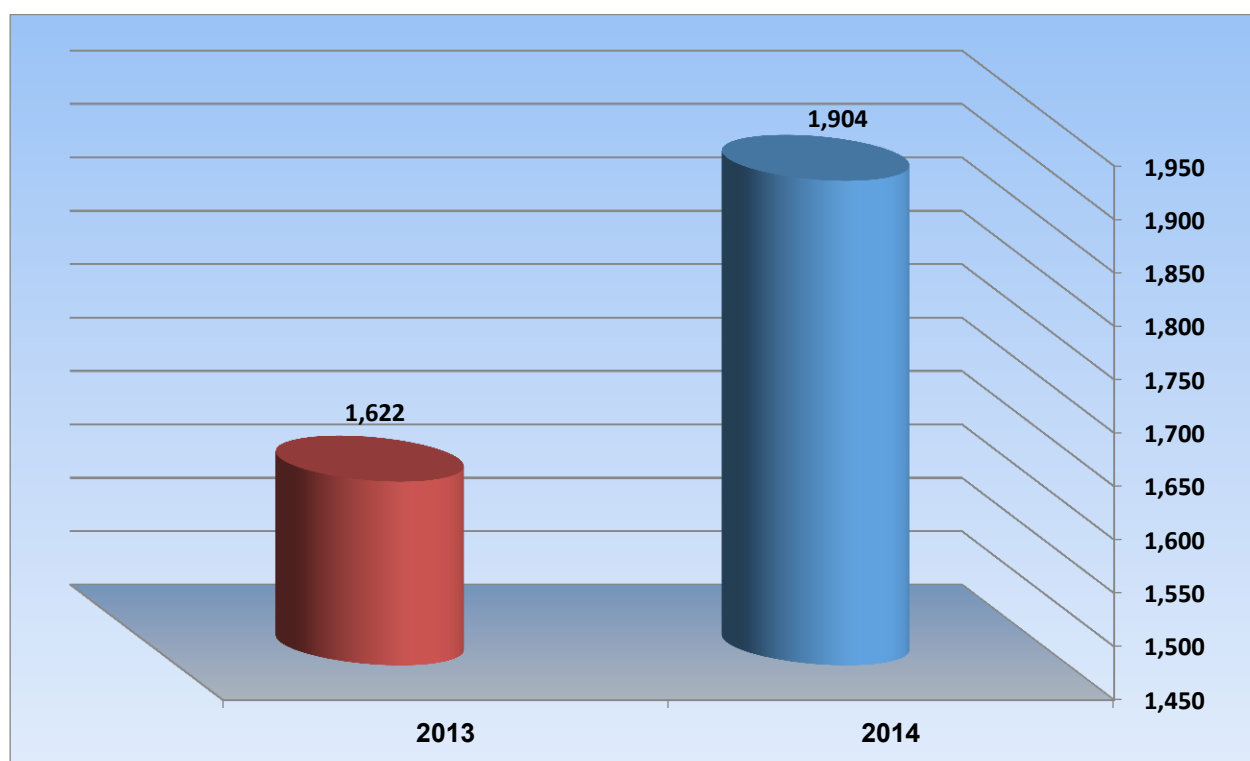
8. REVENUE FROM ROYALTIES

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 Economy ("royalty arrangements"). These royalty arrangements may exist pursuant to laws, regulations, administrative decisions, agreements, arrangements, etc which may vary from time to time. 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 fixed royalty formula in a specific arrangement or 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. Usually, 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.

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

It should be noted that, according to the accounting treatment, 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).

Diagram 1 – Annual comparison – Government revenue from royalties, 2013-2014 (NIS Millions)



State of Israel
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Diagram 2 – Inter-ministry comparison – State income from royalties in 2013-2014 (NIS Millions)

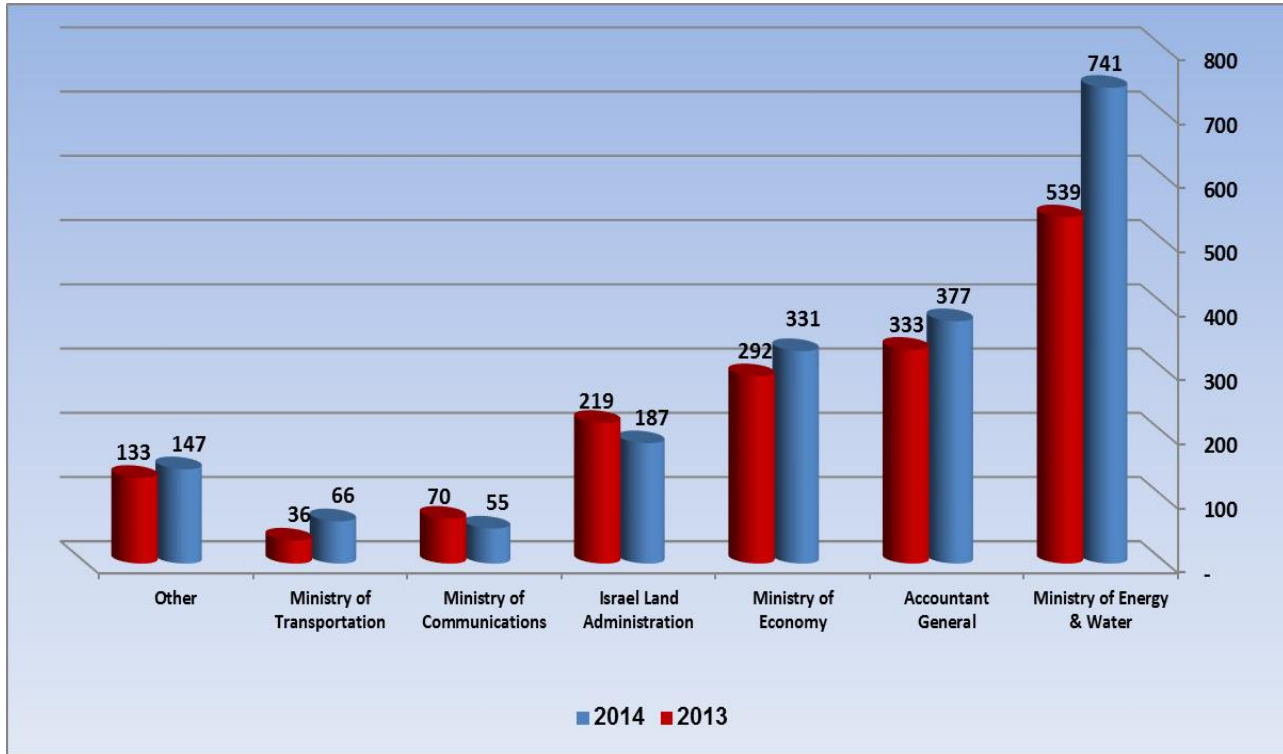
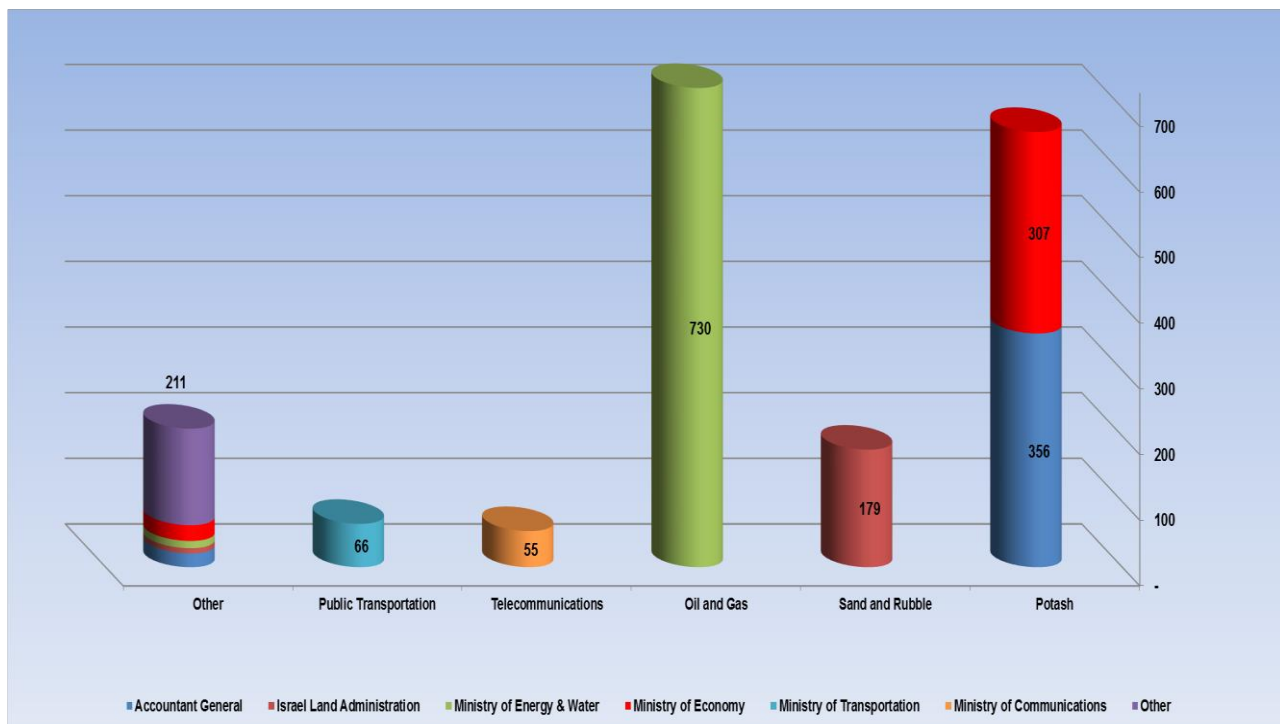


Diagram 3 – Sources of royalties – State income from royalties 2014 (NIS Millions)



State of Israel
Ministry of Finance – Accountant General
Government of Israel – Financial Statements as of December 31 2014

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

The State's total revenue from royalties for January-December 2014 was higher by NIS 282 million (an increase of 15%) as compared to the previous year.

- **Ministry of National Infrastructures, Energy and Water Resources** – The ministry's revenue in 2014 was higher by NIS 202 million as compared to the previous year.

Royalty payer	Sources	2014	2013	(Decrease)/increase
Mary Group	Gas	30	90	(60)
Tamar reservoir	Gas	689	423	266
Rotem Amfert	Potash	11	13	(2)
Meged, Heletz and Arad reservoir	Oil	11	12	(1)

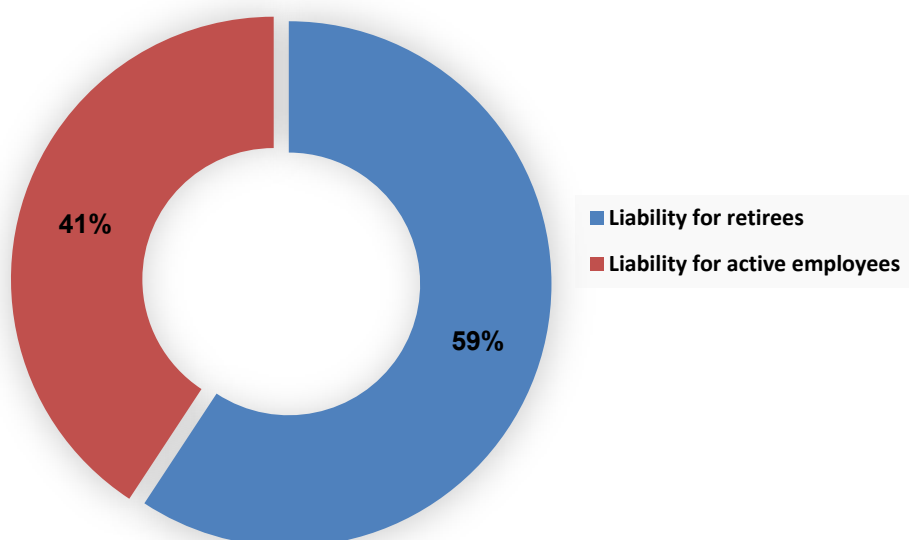
- **Accountant General Division** – The Accountant General's revenue from royalties in 2014 was higher by NIS 44 million than for the previous year. Most of the increase in 2014 is due one-time income of NIS 356 million in royalties from the Dead Sea Works, as a result of the arbitration agreement, in respect of differences from previous years.
- **Ministry of Economy** – The ministry's revenue in 2014 was higher by NIS 39 million than for the previous year. Most of the increase in 2014 is due to royalties from the Dead Sea Works
- **Israel Land Authority** – The authority's revenue from royalties in 2014 was lower by NIS 32 million than for the previous year. Most of the decrease in 2014 is due to accounting time differences in revenue recognition.

9. LIABILITIES FOR BUDGETARY PENSION

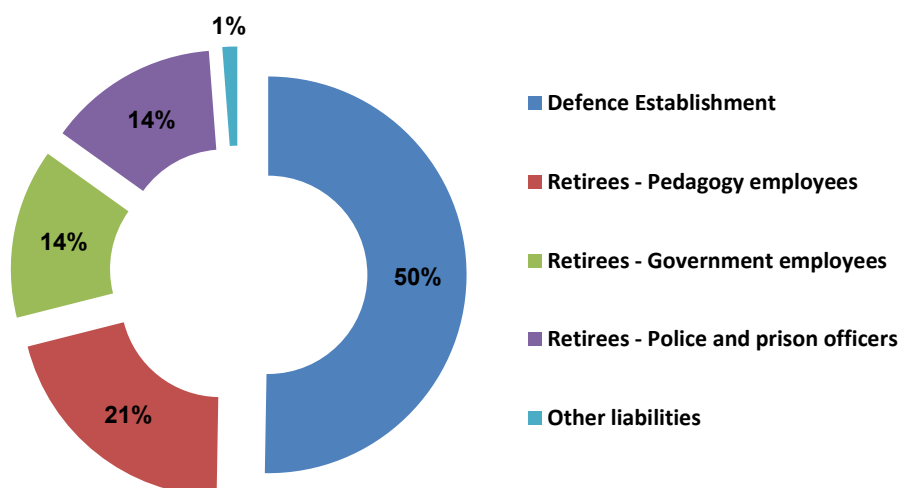
A government employee whose employment commenced before 2002 (2004 for defense entities) is entitled to a budgetary pension paid from the State's current budget, pursuant to the following laws: State Service (Pensions) Law [Consolidated Version], 5730-1970, Permanent Service in the Israel Defense Forces (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, 2014 to NIS 648 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).

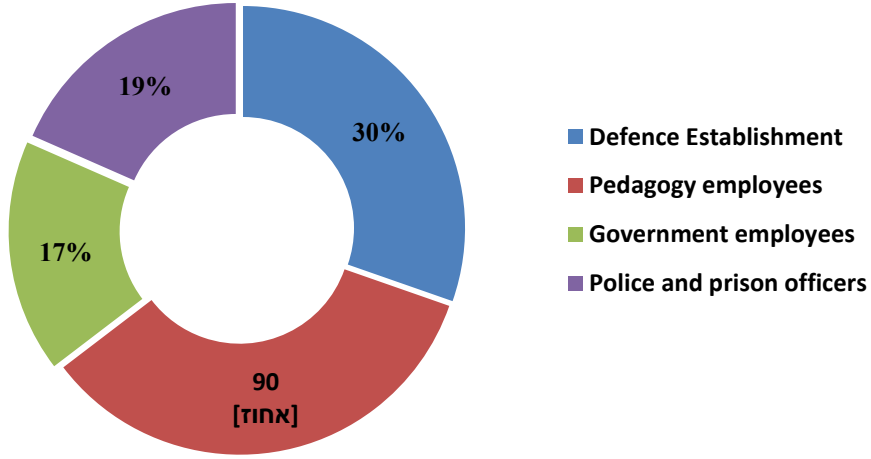
Actuarial liability - NIS 648 Billions



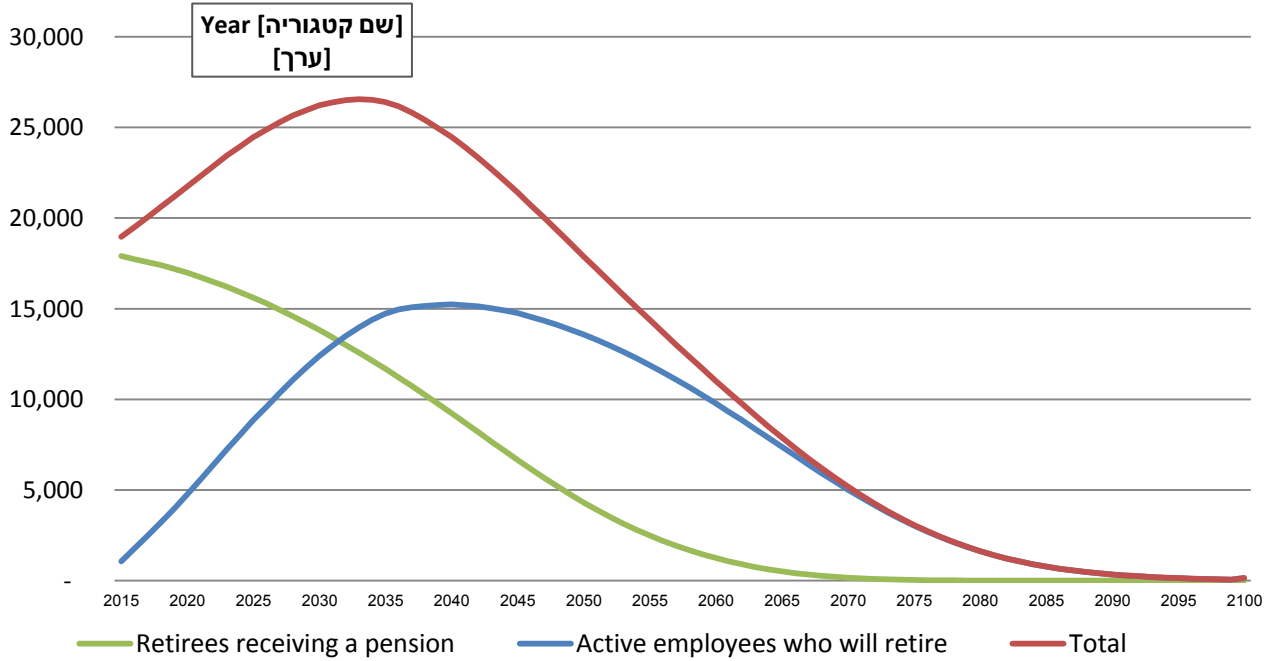
Actuarial liability for retirees - NIS 384 Billions



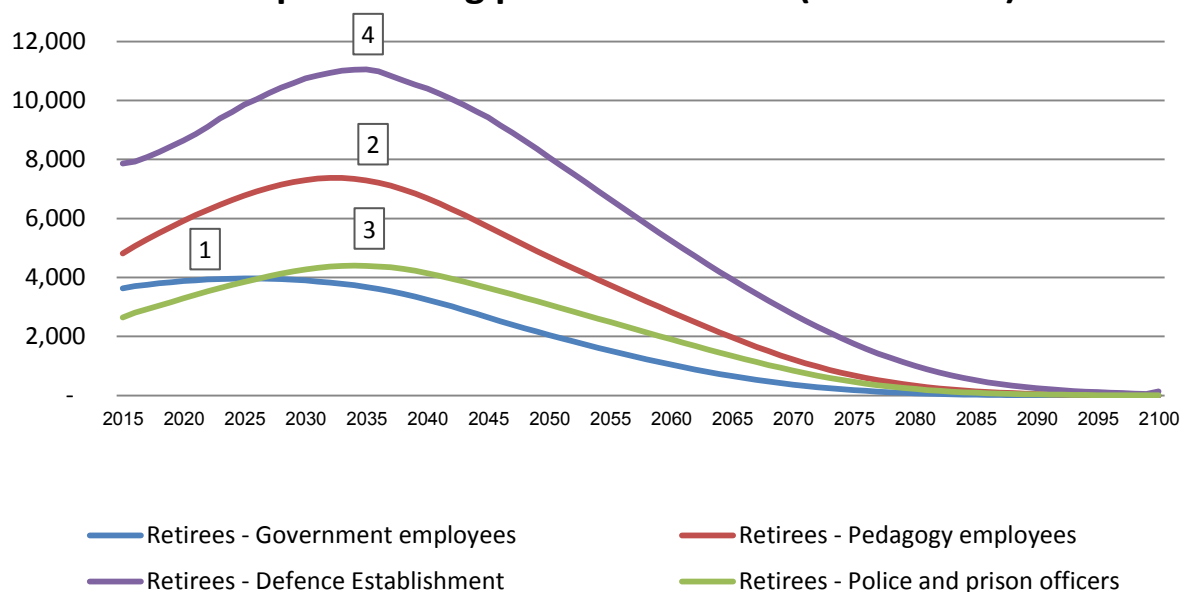
Actuarial Liability for active employees - NIS 264 Billions



Forecast Outflow (NIS Million)



Groups receiving pension forecast (NIS Million)



1. In 2025 total outflow expected for 53,133 government employee retirees is approximately NIS 3,969 Million
2. In 2032 total outflow expected for 86,929 pedagogy employee retirees is approximately NIS 7,373 Million
3. In 2034 total outflow expected for 33,749 police and prison officer retirees is approximately NIS 4,400 Million
4. In 2035 total outflow expected for defence establishment retirees is approximately NIS 11,054 Million

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

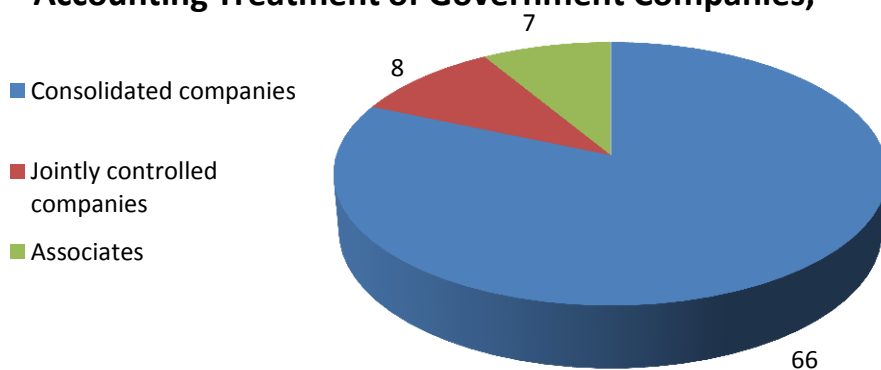
The actuarial liability is an estimate based on the method, data and assumptions as aforesaid. The Government's exact pension liability will become known only upon the death of the employee or the retiree or their survivor who is the last insured. Until then, it is only possible to estimate the liability 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

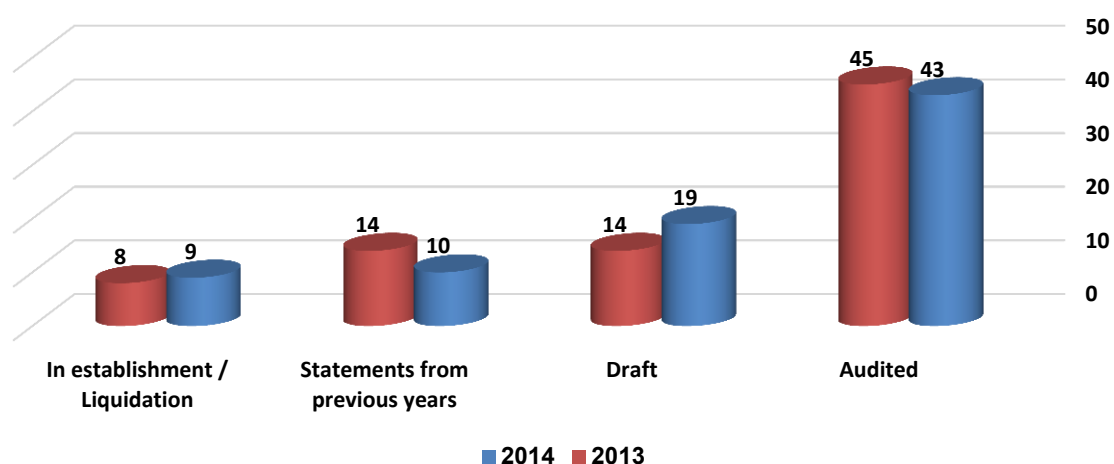
The Government of Israel acts to promote its socioeconomic policy also through investments in government companies and mixed companies, as these terms are defined in the Government Companies Law, 5735-1975 ("the Companies Law"). The activity of the government companies has a significant impact on the economy and on the supply of public services in the areas of infrastructure, construction, electricity, water and so forth. 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. The Government Companies Authority gave information about 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.

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 at that time or on audited/draft financial statements for earlier periods.

Reports of Government Companies 2013-2014



11. GOVERNMENT DISBURSEMENTS

Government Disbursements

The "Government Disbursement Data" publication for 2014, presents government disbursement transactions¹ (excluding net civil service payroll and pension payments) carried out by the Accounting Unit in the Accountant General's Department. The data are shown according to various profiles, including a 2014-over-2013 comparison as well as selected statistical data, and are meant to serve as a tool for optimal planning of government payments through government disbursements, by the government as a whole and by each government ministry.

Following are key data:

Disbursements in 2014 totaled NIS 352 billion compared to NIS 331 billion in 2013 (a 6% increase).

In 2013 there was a continued decrease in the disbursements through the Bohan system, as a result of the transfer of activity to the Merkava system. This trend is expected to continue with the transition of other ministries to Merkavta system.

Monthly disbursements - Based on a comparison with the previous year there was a significant increase in total monthly volume of disbursements in May and August, and a significant decrease in September. **See Diagram 1.**

Government debt disbursements decreased, and account for 31% of total annual disbursements in 2013, as compared to 30% in 2014. The variance between the different months is in accordance with the debt repayment dates in the Government Debt Management Unit **See Diagrams 2.**

Monthly payments by government ministries (net of government debt payments) were in the range of NIS 14-24 billion, apart from December, which recorded the highest disbursements at NIS 31 billion (end of the budget year), representing a gap of 80% as compared to the monthly average.

¹ 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 2014 Compared to 2013**

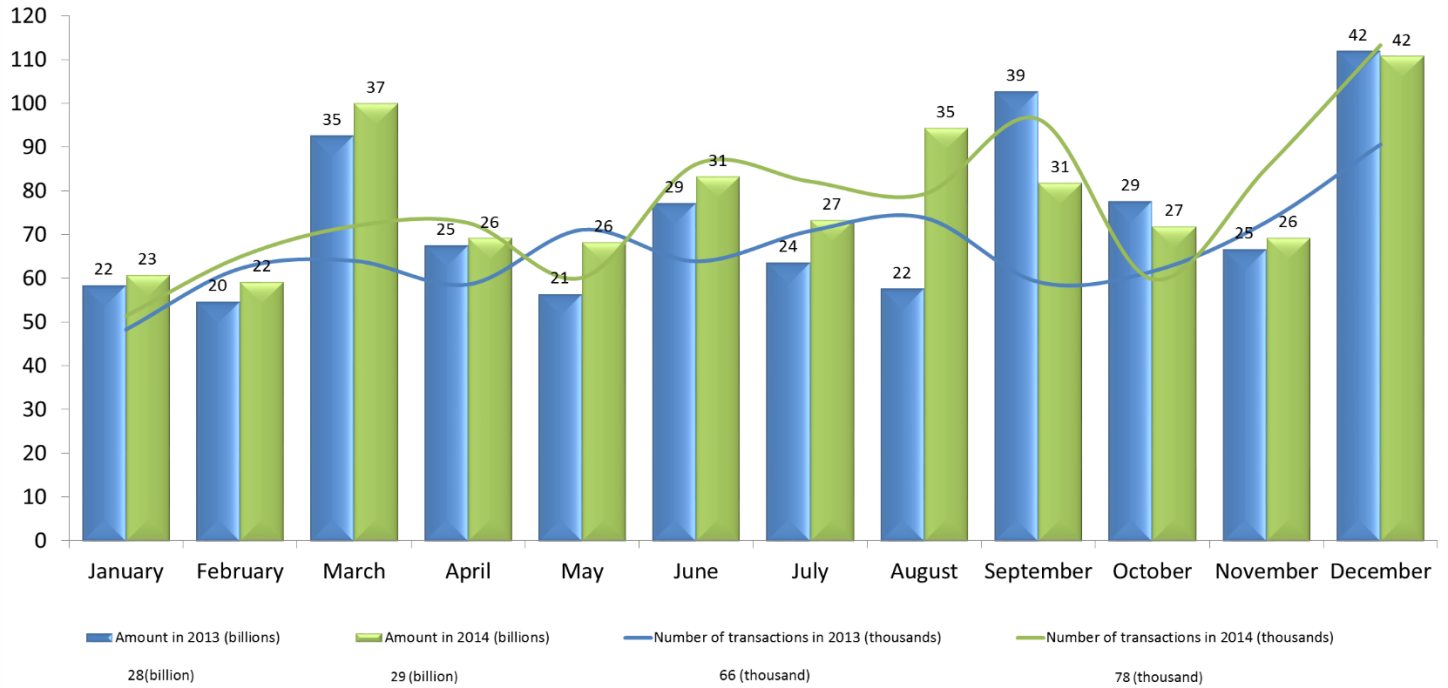
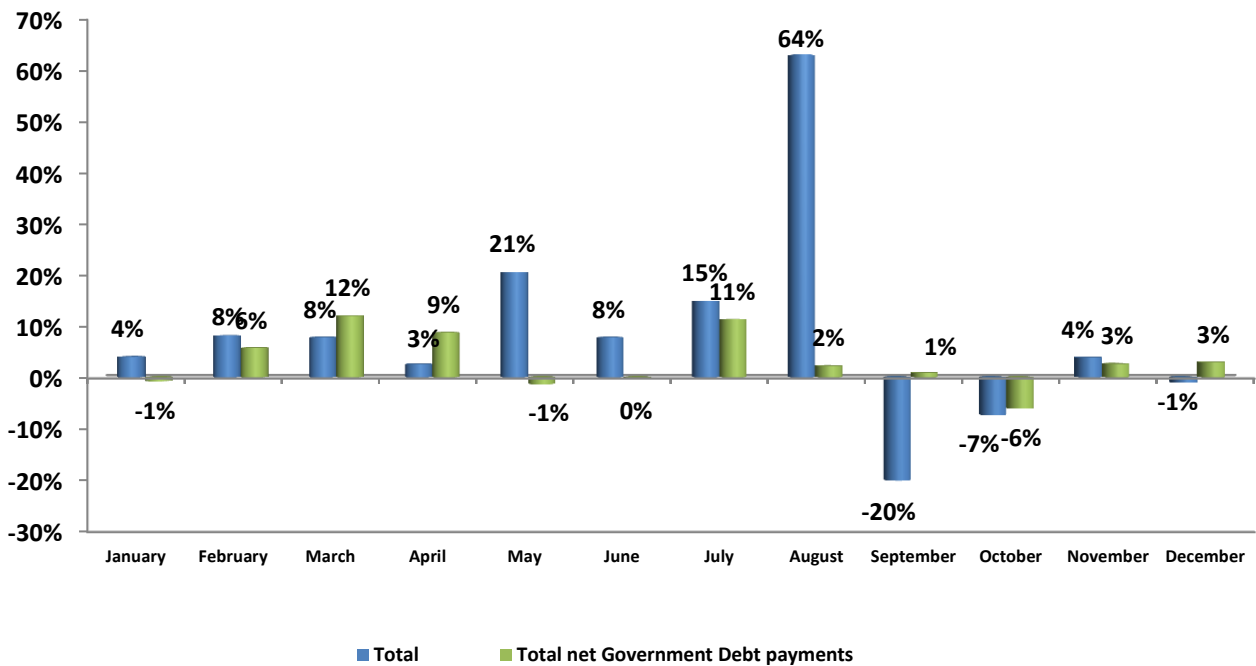


Diagram 2

Total payments Including and Net of Government Debt Payments- 2013-2014



PART B

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

**AS OF DECEMBER 31 2014
(UNAUDITED)**

STATEMENTS OF FINANCIAL POSITION (NIS MILLIONS)

	Note	December 31	
		2014	2013 (*)
Current assets:			
Cash and cash equivalents	3(a)	35,264	33,599
Long-term deposits and investments	4	17,460	15,275
Current maturities in respect of long-term loans	5(a)	2,768	2,863
Accounts receivable	6	45,670	41,716
Current inventory	7	6,303	6,019
Total current assets		107,465	99,472
Non-current assets:			
Long-term loans	5(b)	18,026	21,547
Investments in investee entities ()	8	2,975	2,771
Receivables in respect of royalties	9(a)	8,360	6,815
Other financial assets	10	20,805	18,769
Non-current inventories	7	3,357	3,567
Investment in private partnership projects (PPP)	11	21,715	21,511
Property plant and equipment	12(a)	314,360	307,541
Intangible assets	13	5,549	5,313
Total non-current assets		395,147	387,834
Total assets		502,612	487,306
Contingent assets in respect of royalties from natural resources	9(b)		
State-owned lands	12(b)		

(*)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, 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
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Government of Israel – Financial Statements as of December 31 2014

STATEMENTS OF FINANCIAL POSITION (NIS MILLIONS)

	Note	December 31	
		2014	2013 (*)
Current liabilities:			
Short-term credit	3(b)	1,374	1,025
Domestic loans – current maturities	14	53,613	78,565
Foreign loans – current maturities	15	13,455	13,433
Accounts payable and accruals	16	60,104	56,082
Total current liabilities		128,546	149,105
Non-current liabilities:			
Domestic loans – net of current maturities	14	610,396	574,050
Foreign loans – net of current maturities	15	116,843	102,807
Provision for losses of investees		126,144	124,251
Provision for support of pension funds	17	672,053	596,800
Liabilities in respect of employee benefits	18	522,925	465,882
Reserves for insurance events	19	9,556	8,972
Provision for lawsuits	20	25,479	23,081
Other long-term liabilities	21	17,339	19,079
Liabilities for Public Private Partnerships	11	17,339	19,079
Total non-current liabilities		2,100,735	1,914,922
Total liabilities		2,229,281	2,064,027
State guarantees	22		
Contingent liabilities	23		
Net assets/equity (net liabilities/capital deficiency):			
Attributable to the Government of Israel		(1,727,155)	(1,577,217)
Attributable to non-controlling interests		486	496
Total net liabilities/ capital deficiency		(1,726,669)	(1,576,721)
Total liabilities and capital deficiency		502,612	487,306

(*) 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.

<u>Uzi Sher, CPA</u> Chief Accountant	<u>Michal Abadi-Boiangiu, CPA</u> Accountant General	<u>July 5, 2015</u> Date of approval of the financial statements
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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 2014

STATEMENTS OF FINANCIAL PERFORMANCE (NIS MILLIONS)

	Notes	For the year ended December	
		31	
		2014	2013 (*)
Revenues			
Revenues from taxes and fees	24	316,548	297,868
Revenues from transfers	25	13,770	12,530
Total revenue from non-exchange transactions		330,318	310,398
Revenue exchange transactions	26	75,887	76,418
Other revenues	27	6,042	4,488
Total revenues		412,247	391,304
Expenses			
Payroll and employee benefits	28	180,913	134,285
Appropriations, allocations and transfers	29	234,455	199,514
Operating expenses	30	102,435	103,641
Administrative and general expenses	31	9,583	8,035
Financing expenses, net	32	36,869	30,721
Other expenses		2,571	4,033
Total expenses		566,826	480,229
Share of profits (losses) of investee companies and entities	8	133	134
Net deficit		(154,446)	(88,791)
Attributable to:			
The Government of Israel		(154,436)	(88,805)
Non-controlling interests		(10)	14
Net deficit		(154,446)	(88,791)

(*) 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 the accrual-basis. These principles express changes in assets and liabilities which do not necessarily involve cash flows 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.

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

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

	Note	Balance as of Dec 31 2013(*)	Changes in net assets (**)	Net deficit for the period	Balance as of Dec 31 2014	Attributable to the government	Attributable to non- controlling interests
Accumulated deficit		(1,585,906)	3,582	(154,446)	(1,736,770)	(1,737,256)	486
<u>Non-budgetary capital reserves</u>							
State guarantees fund	35(a)	1,615	104	-	1,719	1,719	-
Compensation fund (property tax)	35(b)	5,388	377	-	5,765	5,765	-
Internal Government Insurance Fund	35(c)	1,150	175	-	1,325	1,325	-
Fund profits tax on oil	35(d)	334	-	-	334	334	-
Other capital reserves		698	260	-	958	958	-
Total non-budgetary capital reserves		9,185	916	-	10,101	10,101	-
Total net liabilities		(1,576,721)	4,498	(154,446)	(1,726,669)	(1,727,155)	486

(*) Restated

(**) inclusive of designation of retained earnings, cumulative effects resulting from recognition of assets, changes in accounting methods and the 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, 2014

NOTE 1 – GENERAL:

- A. The Government of Israel's financial statements as of December 31, 2014, 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 Institute and Israel Airport Authority. A concise description of components of the consolidated financial statements follows (for extensive details see part D 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. 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 controls, 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 information on the financial statements of Government companies, please visit the Government Companies Authority website, at www.gca.gov.il.
 - (5) **The statutory authority** – The statutory authority was established by special legislation which is the source of the powers of the authority. In Israel corporations were established for various purposes,

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Government of Israel – Financial Statements as of December 31 2014

with the accounting activity of some of these corporations being separate from that of the Government. The financial statements as of 31 December 2014 include the financial data of the National Insurance Institution and Israel Airport Authority.

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 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 deviations 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 31 December 2014, or on available quarterly reports for the third quarter of 2014, or on financial statements as of 31 December 2013. The audited information of these investee entities, once published, may be materially different from the information on the basis of which these financial statements were prepared and consolidated.