

FORMULA SYSTEMS (1985) LTD  
Form 20-F/A  
December 31, 2014

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 20-F/A

Amendment No. 1

**REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR 12(g) OF THE SECURITIES EXCHANGE ACT OF 1934**

**OR**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the fiscal year ended December 31, 2013**

**OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**OR**

**SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**Date of event requiring this shell company report \_\_\_\_\_**

**Commission File Number: 000-29442**

**FORMULA SYSTEMS (1985) LTD.**

(Exact Name of Registrant as Specified in Its Charter and translation of Registrant's name into English)

**Israel**

(Jurisdiction of Incorporation or Organization)

**5 Haplada Street, Or Yehuda 60218, Israel**

(Address of Principal Executive Offices)

**Asaf Berenstin; 5 Haplada Street, Or Yehuda 60218, Israel**

Tel: 972 3 5389487, Fax: 972 3 5389645

(Name, Telephone, E-mail and/or Facsimile Number and Address of Company Contact Person)

\_\_\_\_\_

Securities registered or to be registered pursuant to Section 12(b) of the Act:

<u>Title of Each Class</u>	<u>Name of Each Exchange On Which Registered</u>
<b>American Depositary Shares, each representing one Ordinary Share, NIS 1 par value</b>	<b>NASDAQ Global Select Market</b>

Securities registered or to be registered pursuant to Section 12(g) of the Act: **None**

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: **None**

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report:

**As of December 31, 2013, the registrant had 14,718,782 outstanding ordinary shares, NIS 1 par value, of which 356,802 were represented by American Depositary Shares.**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP  International Financial Reporting Standards as issued by the International Accounting Standards Board  Other

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.

Item 17  Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

## **EXPLANATORY NOTE**

This Amendment No. 1, or the Amendment, to the Annual Report on Form 20-F for the year ended December 31, 2013, or the Annual Report, filed on April 30, 2014 with the Securities and Exchange Commission, or the SEC, is being filed by Formula Systems (1985) Ltd., or the Company, to amend the Annual Report for the sole purpose of adding, in accordance with Rule 2-05 of Regulation S-X, the reports of the auditors of certain of our affiliated companies upon which our principal auditor relied, and to which our principal auditor referred, in rendering its audit report on our consolidated financial statements that was included in the Annual Report. The subject audit reports had been inadvertently omitted from the Annual Report.

In keeping with the SEC requirements related to this Amendment, it consists solely of (i) the entirety of Item 18 of Form 20-F, along with (ii) Exhibits 12.1 and 12.2, which constitute the required certifications of our principal executive officer and principal financial officer pursuant to Rule 13a-14(a)/Rule 15d-14(a) under the Securities Exchange Act of 1934, as amended, or the Exchange Act, (iii) Exhibits 13.1 and 13.2, which consist of the certifications of our principal executive officer and principal financial officer pursuant to Rule 13a-14(b)/Rule 15d-14(b) under the Exchange Act and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, and (iv) the consents of our accountants that serve as Exhibits 15.1 through 15.5 to the Amendment.

Other than as expressly set forth above, this Amendment does not, and does not purport to, amend, update or restate the information in any other item of the Annual Report, or reflect any events that have occurred after the Annual Report was originally filed.

## ITEM 18. FINANCIAL STATEMENTS

Our consolidated financial statements and the report of our independent registered public accounting firm in connection therewith are filed as part of this Amendment to the Annual Report, as noted on the pages below:

Report of Independent Registered Public Accounting Firm	F-3-F-5
Consolidated Balance Sheets at December 31, 2013 and 2012	F-6-F-7
Consolidated Statements of Income for the Years Ended December 31, 2013, 2012 and 2011	F-8
Consolidated Statements of Comprehensive Income	F-9
Statements of Changes in Equity for the Years Ended December 31, 2013, 2012 and 2011	F-10-F-11
Consolidated Statements of Cash Flows for the Years Ended December 31, 2013, 2012 and 2011	F-12-F-15
Notes to Consolidated Financial Statements	F-16-F-74

## ITEM 19. EXHIBITS

### Exhibit No.

<b>1.1</b>	Memorandum of Association <sup>(1)</sup>
<b>1.2</b>	Amended and Restated Articles of Association, as adopted by Formula Systems (1985) Ltd. on January 8, 2012 <sup>(2)</sup>
<b>2.1</b>	Depositary Agreement by and among Formula Systems (1985) Ltd., Bank of New York Mellon and the holders of the American Depositary Shares of Formula Systems (1985) Ltd. <sup>(1)</sup>
<b>4.1</b>	Form of Letter of Indemnification for officers and directors, adopted by Formula Systems (1985) Ltd. on January 8, 2012 <sup>(3)</sup>
<b>4.2</b>	English translation of Formula Systems (1985) Ltd. Employees and Office Holders Share Option Plan (2008) <sup>(4)</sup>
<b>4.3</b>	Formula Systems (1985) Ltd. 2011 Share Incentive Plan and amendment +
<b>8</b>	List of Subsidiaries+
<b>12.1</b>	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a)/Rule 15d-14(a) under the Exchange Act*
<b>12.2</b>	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a)/Rule 15d-14(a) under the Exchange Act*
<b>13.1</b>	Certification of the Chief Executive Officer pursuant to Rule 13a-14(b)/Rule 15d-14(b) under the Exchange Act and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002*
<b>13.2</b>	Certification of the Chief Financial Officer pursuant to Rule 13a-14(b)/Rule 15d-14(b) under the Exchange Act and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002*
<b>15.1</b>	Consent of Kost, Forer, Gabbay & Kaiserer, a member of Ernst & Young Global*
<b>15.2</b>	Consent of Levy Cohen and Co.*
<b>15.3</b>	Consent of Levy Cohen and Co.*

**15.4** Consent of Levy Cohen and Co.\*

**15.5** Consent of KDA Audit Corporation\*

**101** The following financial information from Formula Systems (1985) Ltd.'s annual report on Form 20-F for the year ended December 31, 2013 formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheets at December 31, 2012 and 2013; (ii) Consolidated Statements of Income for the years ended December 31, 2011, 2012 and 2013; (iii) Consolidated Statements of Comprehensive Income for the years ended December 31, 2011, 2012 and 2013; (iv) Consolidated Statements of Changes in Equity for the years ended December 31, 2011, 2012 and 2013; (v) Consolidated Statements of Cash Flows for the years ended December 31, 2011, 2012 and 2013; and (vi) Notes to the Consolidated Financial Statements, tagged as blocks of text. Users of this data are advised, in accordance with Rule 406T of Regulation S-T promulgated by the SEC, that this Interactive Data File is deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act, is deemed not filed for purposes of Section 18 of the Exchange Act, and otherwise is not subject to liability under those sections.+

+ Filed with the original filing of the Annual Report.

\*Filed herewith.

(1) Incorporated by reference to the Registration Statement on Form F-1 (File No. 333-8858) filed with respect to the registrant's American Depositary Shares.

(2) Incorporated by reference to Exhibit 99.1 to the report on Form 6-K filed by the registrant with the Securities and Exchange Commission on January 18, 2012.

(3) Incorporated by reference to Exhibit 99.2 to the report on Form 6-K filed by the registrant with the Securities and Exchange Commission on January 18, 2012.

(4) Incorporated by reference to the annual report on Form 20-F for the 2008 fiscal year filed by the registrant with the Securities and Exchange Commission on April 27, 2009.

**SIGNATURES**

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this Amendment No. 1 to the annual report on its behalf.

FORMULA SYSTEMS (1985) LTD.

By: /s/Asaf Berenstin	<u>December 31, 2014</u>
Asaf Berenstin	Date
Chief Financial Officer	

**FORMULA SYSTEMS (1985) LTD. AND ITS SUBSIDIARIES**

**CONSOLIDATED FINANCIAL STATEMENTS**

**AS OF DECEMBER 31, 2013**

**FORMULA SYSTEMS (1985) LTD. AND ITS SUBSIDIARIES**

**CONSOLIDATED FINANCIAL STATEMENTS**

**AS OF DECEMBER 31, 2013**

**U.S. DOLLARS IN THOUSANDS**

**INDEX**

	<b>Page</b>
<b>Reports of Independent Registered Public Accounting Firm</b>	<b>F-3 - F-5</b>
<b>Consolidated Balance Sheets</b>	<b>F-6 - F-7</b>
<b>Consolidated Statements of Income</b>	<b>F-8</b>
<b>Consolidated Statements of Comprehensive Income</b>	<b>F-9</b>
<b>Statements of Changes in Equity</b>	<b>F-10 - F-11</b>
<b>Consolidated Statements of Cash Flows</b>	<b>F-12 - F-15</b>
<b>Notes to Consolidated Financial Statements</b>	<b>F-16 - F-74</b>

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

**To the Board of Directors and the Shareholders of**

**FORMULA SYSTEMS (1985) LTD.**

We have audited the accompanying consolidated balance sheets of Formula Systems (1985) Ltd. and its subsidiaries (the "Company") as of December 31, 2012 and 2013 and the related consolidated statements of income, statements of comprehensive income, changes in equity and cash flows for each of the three years in the period ended December 31, 2013. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of certain subsidiaries, which statements reflect total assets of 1% as of each of December 31, 2012 and 2013, and total revenues of 3% for each of the years ended December 31, 2011, 2012 and 2013, respectively, of the related consolidated totals. Those statements were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included for those subsidiaries, is based solely on the reports of the other auditors.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, based on our audits and the reports of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries as of December 31, 2012 and 2013 and the related consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2013, in conformity with U.S generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated April 30, 2014 expressed an unqualified opinion thereon.

Tel-Aviv, Israel /s/ Kost Forer Gabbay & Kasierer  
April 30, 2014 KOST FORER GABBAY & KASIERER  
A Member of Ernst & Young Global

F-3

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

**To the Board of Directors and Shareholders of**

**FORMULA SYSTEMS (1985) LTD.**

We have audited Formula Systems (1985) Ltd.'s ("Formula" or the "Company") internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on COSO criteria.

F-4

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of the Company and its subsidiaries as of December 31, 2012 and 2013, and the related consolidated statements of income, comprehensive income, changes in equity and cash flows for each of the three years ended December 31, 2011, 2012 and 2013, respectively, and our report dated April 30, 2014 expressed an unqualified opinion thereon.

Tel-Aviv, Israel /s/ Kost Forer Gabbay & Kasierer  
April 30, 2014 KOST FORER GABBAY & KASIERER  
A Member of Ernst & Young Global

F-5

**FORMULA SYSTEMS (1985) LTD.****AND ITS SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****U.S. dollars in thousands**

	December 31,	
	2012	2013
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 111,238	\$ 82,123
Marketable securities (Note 4)	14,866	17,956
Short-term deposits	-	672
Trade receivables (net of allowances for doubtful accounts of \$ 4,033 and \$ 5,066 as of December 31, 2012 and 2013, respectively)	201,886	201,144
Other accounts receivable and prepaid expenses (Note 17a)	38,863	34,609
Inventories	2,149	2,407
<u>Total</u> current assets	369,002	338,911
<b>LONG-TERM RECEIVABLES:</b>		
Marketable Securities (Note 4)	331	520
Deferred taxes (Note 16e)	13,618	13,152
Prepaid expenses and other accounts receivable	5,285	8,761
<u>Total</u> long-term receivables	19,234	22,433
INVESTMENTS IN AFFILIATED COMPANIES (Note 6)	3,022	161,501
SEVERANCE PAY FUND	66,799	68,148
PROPERTY, PLANTS AND EQUIPMENT, NET (Note 7)	21,459	19,408
INTANGIBLE ASSETS, NET (Note 9)	75,260	39,643
GOODWILL (Note 8)	326,860	227,434
<u>Total</u> assets	\$ 881,636	\$ 877,478

The accompanying notes are an integral part of the financial statements.

F-6

**FORMULA SYSTEMS (1985) LTD.****AND ITS SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****U.S. dollars in thousands (except share and per share data)**

	December 31,	
	2012	2013
<b>LIABILITIES AND EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Liabilities to banks (Note 17b)	\$23,607	\$35,636
Debentures (Note 11)	15,735	-
Trade payables	51,943	52,645
Deferred revenue	33,998	28,454
Dividend payable	-	4,565
Employees and payroll accrual	62,089	54,365
Other accounts payable (Note 17c)	30,830	22,853
Liabilities in respect of business combinations	5,808	12,452
<b><u>Total</u> current liabilities</b>	<b>224,010</b>	<b>210,970</b>
<b>LONG-TERM LIABILITIES:</b>		
Liabilities to banks and others (Note 10)	64,659	62,447
Deferred taxes (Note 16e)	7,984	8,157
Deferred revenue	1,346	4,990
Liability in respect of business combinations	9,293	2,871
Liability in respect of capital lease	1,733	1,418
Accrued severance pay	81,832	81,258
<b><u>Total</u> long-term liabilities</b>	<b>166,847</b>	<b>161,141</b>
<b>COMMITMENTS AND CONTINGENCIES (Note 14)</b>		
<b>REDEEMABLE NON-CONTROLLING INTEREST (Note 2d)</b>	<b>22,117</b>	<b>23,529</b>
<b>EQUITY (Note 15):</b>		
<b>Formula Systems (1985) equity:</b>		
<b>Share capital:</b>		
Ordinary shares of NIS 1 par value -		
Authorized: 25,000,000 shares at December 31, 2012 and 2013;		
Issued: 14,164,620 and 15,287,402 at December 31, 2012 and 2013, respectively.		

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Outstanding: 13,596,000 and 14,718,782 at December 31, 2012 and 2013, respectively	3,876	4,181
Additional paid-in capital	132,767	132,325
Accumulated earnings	115,778	186,754
Accumulated other comprehensive loss	(7,095 )	(816 )
Treasury shares (568,620 shares as of December 31, 2012 and 2013)	(259 )	(259 )
Total Formula Systems (1985) shareholders' equity	245,067	322,185
Non-controlling interests	223,595	159,653
<u>Total</u> equity	468,662	481,838
<u>Total</u> liabilities, redeemable non-controlling interest and equity	\$881,636	\$877,478

The accompanying notes are an integral part of the financial statements.

F-7

**FORMULA SYSTEMS (1985) LTD.****AND ITS SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME****U.S. dollars in thousands (except share and per share data)**

	Year ended December 31,		
	2011	2012	2013
Revenues (Note 17g):			
Proprietary software products and related services	\$91,288	\$164,173	\$179,400
Software services	549,329	580,558	617,274
Total revenues	640,617	744,731	796,674
Cost of revenues:			
Proprietary software products and related services	38,805	83,784	96,180
Software services	454,081	481,019	506,900
Total cost of revenues	492,886	564,803	603,080
Gross profit	147,731	179,928	193,594
Research and development costs, net	5,148	12,349	14,168
Selling, marketing, general and administrative expenses	93,340	110,758	117,877
Other expenses (income), net (Note 17e)	(207 )	(174 )	14
Operating income	49,450	56,995	61,535
Financial expenses, net (Note 17d)	(6,500 )	(6,672 )	(6,236 )
Income before taxes on income	42,950	50,323	55,299
Taxes on income (Note 16g)	5,689	6,583	8,926
	37,261	43,740	46,373
Equity in gains (losses) of affiliated companies, net (Note 6)	25,870	3,744	60,683
Net income	63,131	47,484	107,056
Change in redeemable non-controlling interests	-	(967 )	1,735
Net income attributable to non-controlling interests	20,169	24,421	24,336
Net income attributable to Formula Systems (1985) shareholders	\$42,962	\$24,030	\$80,985

Net earnings per share attributable to Formula Systems (1985)  
Shareholders (Note 17h)

Basic	\$3.17	\$1.78	\$5.90
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Diluted	\$3.11	\$1.72	\$5.70
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Shares used in computing earnings per share (Note 17h):

Basic	13,513,500	13,596,000	13,724,652
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Diluted	13,669,297	13,789,766	14,122,779
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The accompanying notes are an integral part of the financial statements.

**FORMULA SYSTEMS (1985) LTD.****AND ITS SUBSIDIARIES****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****U.S. dollars in thousands**

	Year ended December 31,		
	2011	2012	2013
Net income	\$63,131	\$47,484	\$107,056
Other comprehensive income (loss), net of tax			
Foreign currency translation adjustments	(17,948)	5,744	12,911
Unrealized gain (loss) from derivative instruments, net	(55 )	29	143
Unrealized gain (loss) from available-for-sale securities, net	(192 )	(56 )	170
Realized gain (loss) from derivative instruments, net	32	-	-
Realized loss (gain) from available-for-sale securities	714	669	-
Total other comprehensive income (loss), net of tax	(17,449)	6,386	13,224
Total Comprehensive income	45,682	53,870	120,280
Comprehensive income attributable to redeemable non-controlling interests	-	(1,021 )	1,735
Comprehensive income attributable to non-controlling interests	14,419	25,607	31,281
Comprehensive income attributable Formula Systems (1985) shareholders	\$31,263	\$29,284	\$87,264

The accompanying notes are an integral part of the financial statements.

**FORMULA SYSTEMS (1985) LTD.****AND ITS SUBSIDIARIES****STATEMENTS OF CHANGES IN EQUITY****U.S. dollars in thousands (except share and per share data)**

	Share Capital Number	Capital Amount	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income (loss)	Treasury shares (cost)	Non- controlling interests	Total Equity
<b>Balance as of January 1, 2011</b>	13,596,000	\$3,807	\$136,222	\$58,441	\$ (596 )	\$ (259 )	\$136,769	\$334,384
Net Income	-	-	-	42,962	-	-	20,169	63,131
Other comprehensive income (loss)	-	-	-	-	(11,699 )	-	(5,750 )	(17,449 )
Stock-based Compensation expenses (Note 12a)	-	-	2,120	-	-	-	2,503	4,623
Exercise of employees stock options (Note 12a)	543,840	226	(226 )	-	-	-	-	-
Redemption of shares (Note 12a)	(543,840 )	(157 )	157	-	-	-	-	-
Non-controlling interests changes due to holding changes including exercise of employees stock options	-	-	(537 )	-	-	-	(7,607 )	(8,144 )
Acquisition of non-controlling interests	-	-	(2,062 )	-	-	-	(3,146 )	(5,208 )
Dividend to Formula's shareholders	-	-	-	(9,731 )	-	-	-	(9,731 )
Dividend to non- controlling interests in subsidiaries	-	-	-	-	-	-	(9,418 )	(9,418 )

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<b>Balance as of December 31, 2011</b>	13,596,000	3,876	135,674	91,672	(12,295 )	(259 )	133,520	352,188
Net Income	-	-	-	24,030	-	-	24,421	48,451
Other comprehensive income	-	-	-	-	5,200	-	1,186	6,386
Stock-based Compensation	-	-	1,988	-	-	-	2,932	4,920
expenses (Note 12a)								
Non-controlling interests changes due to holding changes, including exercise of employees stock options and repurchase of shares by subsidiaries	-	-	(1,733 )	-	-	-	(4,073 )	(5,806 )
Acquisition of non-controlling interests	-	-	(3,162 )	-	-	-	76,475	73,313
Non-controlling interest as part of acquisitions	-	-	-	-	-	-	175	175
Return of prior year Formula's shareholders' dividend withheld tax	-	-	-	76	-	-	-	76
Dividend to non- controlling interests in subsidiaries	-	-	-	-	-	-	(11,041 )	(11,041 )
Balance as of December 31, 2012	13,596,000	\$3,876	\$132,767	\$115,778	\$(7,095 )	\$(259 )	\$223,595	\$468,662

The accompanying notes are an integral part of the financial statements.

**FORMULA SYSTEMS (1985) LTD.****AND ITS SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY****U.S. dollars in thousands (except share and per share data)**

	Share Number	Capital Amount	Additional paid-in capital	Retained earnings	Accumulated other comprehensive <b>income</b> (loss)	Treasury shares (cost)	Non- controlling interests	Total Equity
Balance as of January 1, 2013	13,596,000	\$ 3,876	\$ 132,767	\$ 115,778	\$ (7,095 )	\$ (259 )	\$ 223,595	\$ 468,662
Net Income	-	-	-	80,985	-	-	24,336	105,321
Other comprehensive income	-	-	-	-	6,279	-	6,945	13,224
Stock-based Compensation expenses (Note 12a)	-	-	1,988	-	-	-	1,990	3,978
Exercise of employees stock options (Note 12a)	1,122,782	305	(302 )	-	-	-	-	3
Non-controlling interests changes due to holding changes, including exercise of employees stock options and repurchase of shares by subsidiaries	-	-	(715 )	-	-	-	(80,677 )	(81,392 )
Acquisition of non-controlling interests	-	-	(1,413 )	-	-	-	(1,377 )	(2,790 )
Dividend to Formula's shareholders	-	-	-	(10,009 )	-	-	-	(10,009 )
Dividend to non-controlling interests in subsidiaries	-	-	-	-	-	-	(15,159 )	(15,159 )
	14,718,782	\$ 4,181	\$ 132,325	\$ 186,754	\$ (816 )	\$ (259 )	\$ 159,653	\$ 481,838

**Balance as of  
December 31, 2013**

	Year ended December 31,		
	2011	2012	2013
Accumulated unrealized gain (loss) from available-for-sale securities	\$(396 )	\$288	\$468
Accumulated currency translation adjustments	(11,895)	(7,309)	(1,284)
Accumulated unrealized gain (loss) from derivative instruments	(4 )	(74 )	-
Accumulated other comprehensive loss	\$(12,295)	\$(7,095)	\$(816 )

The accompanying notes are an integral part of the financial statements.

F-11

**FORMULA SYSTEMS (1985) LTD.****AND ITS SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS****U.S. dollars in thousands**

	Year ended December 31,		
	2011	2012	2013
Cash flows from operating activities:			
Net income	\$63,131	\$47,484	\$107,056
Adjustments to reconcile net income to net cash provided by operating activities:			
Impairment of available for sale marketable securities	714	700	-
Gain derived from deconsolidation of subsidiary, consolidation of affiliate and equity in losses )gains) of affiliated companies	(25,870)	(3,744 )	(60,684 )
Depreciation and amortization	14,363	25,650	24,349
Changes in value of debentures	2,496	2,070	670
Increase (decrease) in accrued severance pay, net	3,025	(1,132 )	(1,645 )
Gain from sale of operation and subsidiaries	(630 )	(136 )	-
Loss (gain) from sale of property, plants and equipment	(2 )	-	15
Stock-based compensation expenses	4,623	4,920	3,978
Changes in value of long term loans and deposits, net	133	360	21
Changes in deferred taxes, net	(3,798 )	(485 )	926
Change in liability in respect of business combinations	1,292	429	(845 )
Loss (gain) from sale and decrease (increase) in value of marketable securities classified as trading	1,421	(376 )	(472 )
Realized gain from sale of available for sale securities	-	(31 )	-
Changes in operating assets and liabilities:			
Decrease (increase) in inventories	2,938	346	(128 )
Increase in trade receivables	(21,795)	(1,674 )	(6,451 )
Decrease (increase) in other current and long-term accounts receivable	(9,924 )	2,506	(9,113 )
Increase (decrease) in trade payables	(10,584)	3,421	3,324
Increase (decrease) in other accounts payable and employees and payroll accrual	4,386	(7,448 )	2,515
Increase (decrease) in deferred revenues	(86 )	208	5,035
Net cash provided by operating activities	\$25,833	\$73,068	\$68,551

The accompanying notes are an integral part of the financial statements.



**FORMULA SYSTEMS (1985) LTD.****AND ITS SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS****U.S. dollars in thousands**

	Year ended December 31,		
	2011	2012	2013
Cash flows from investing activities:			
Payments for business acquisitions, net of cash acquired (Appendix C)	\$(40,188 )	\$(20,047 )	\$(13,253 )
Purchase of controlling interest in an affiliated company, net of cash acquired (Appendix D)	-	14,052	-
Changes due to deconsolidation and realization of investments in previously-consolidated subsidiaries (Appendix E)	(16,599 )	-	(31,105 )
Proceeds from sale of activity in a consolidated company	-	136	-
Changes in restrictions on short term deposit	-	-	(193 )
Purchase of property and equipment	(8,907 )	(4,994 )	(6,868 )
Proceeds from sale of (investment in) marketable securities, net	21,500	2,507	(1,519 )
Proceeds from sale of property, plants and equipment	43	-	102
Investment in and loans to affiliates and other companies	(8,765 )	(364 )	-
Changes in short term deposits, net	(5,179 )	5,235	(597 )
Capitalization of software development and other costs	(9,744 )	(8,433 )	(9,899 )
Net cash used in investing activities	(67,839 )	(11,908 )	(63,332 )
Cash flows from financing activities:			
Exercise of employees stock options in subsidiaries	890	1,508	3,036
Dividend paid to non-controlling interests in subsidiaries	(9,418 )	(12,940 )	(16,648 )
Dividend to Formula's shareholders	(9,731 )	76	(5,444 )
Short-term bank credit, net	5,043	422	2,301
Repayment of long-term loans from banks and others	(6,461 )	(12,982 )	(17,586 )
Proceeds from long term loans	45,420	41,505	21,493
Purchase of non-controlling interests and redeemable non-controlling interests	(5,187 )	(19,166 )	(4,447 )
Cash paid in conjunction with acquisitions of activities	-	(3,669 )	(3,863 )
Repayment of capital lease	(213 )	(188 )	(456 )
Repayment of debenture	-	(33,015 )	(16,792 )
Net cash provided by (used in) financing activities	20,343	(38,449 )	(38,406 )
Effect of exchange rate changes on cash and cash equivalents	(673 )	355	4,072

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Increase (decrease) in cash and cash equivalents	(22,336 )	23,066	(29,115 )
Cash and cash equivalents at beginning of year	110,508	88,172	111,238
Cash and cash equivalents at end of year	\$88,172	\$111,238	\$82,123

The accompanying notes are an integral part of the financial statements.

F-13

**FORMULA SYSTEMS (1985) LTD.****AND ITS SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS****U.S. dollars in thousands**

	Year ended December 31,		
	2011	2012	2013
A. Supplemental cash flow information:			
Cash paid in respect of:			
Interest	1,628	4,251	1,978
Income tax	13,843	17,986	14,714
B. Non-cash activities:			
Purchase of property and equipment	2,696	-	2,780
C. Acquisition of newly-consolidated subsidiaries and activities, net of cash acquired:			
Assets and liabilities of subsidiaries consolidated as of acquisition date:			
Working capital (other than cash and cash equivalents)	(1,326 )	(3,312 )	(1,534 )
Property and equipment	(1,534 )	(760 )	(78 )
Goodwill and intangible assets	(51,297)	(43,536 )	(16,891)
Long-term liabilities	13,385	7,215	5,038
Deferred tax liability, net	2,181	687	212
Liability to formerly shareholders	7,483	-	-
Cash designated to distribution to former shareholders	(4,821 )	-	-
Cash paid in conjunction with acquisitions of activities	(6,020 )	(140 )	-
Redeemable non-controlling interests at acquisition date	-	19,555	-
Non-controlling interests at acquisition date	1,761	244	-
Total	(40,188)	(20,047 )	(13,253)
D. Purchase of controlling interests in an affiliated company, net of cash acquired:			
Assets and liabilities of subsidiaries consolidated as of acquisition date:			
Working capital (other than cash and cash equivalents)	-	10,835	-
Property and equipment	-	(1,814 )	-
Goodwill and intangible assets	-	(155,740)	-
Long-term liabilities	-	3,211	-
Deferred tax asset, net	-	(247 )	-

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Investment in affiliated company	-	75,242	-
Non-controlling interests at acquisition date	-	82,565	-
Total	-	14,052	-

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

F-14

**FORMULA SYSTEMS (1985) LTD.****AND ITS SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS****U.S. dollars in thousands**

	Year ended December 31,		
	2011	2012	2013
E. Changes due to deconsolidation and realization of investments in previously-consolidated subsidiaries:			
Working capital (other than cash and cash equivalents)	(7,796 )	-	(12,114 )
Property and equipment	1,220	-	4,085
Other assets, deferred expenses and long term payables	3,527	-	571
Goodwill and intangible assets	42,269	-	160,960
Non-controlling interests at loss of control date	(10,916 )	-	(84,228 )
Investment in affiliated company presentation due to loss of control	(71,366 )		(158,592 )
Adjustment to other comprehensive (loss) gain	-	-	(2,951 )
Gain from realization of investments in subsidiaries	26,463	-	61,164
Total	(16,599 )	-	(31,105 )

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

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**NOTE 1:- GENERAL**

Formula Systems (1985) Ltd. ("Formula") was incorporated in Israel and began its business operations in 1985. Since 1991, Formula's ordinary shares, par value NIS 1.0 per share, have been traded on the Tel-Aviv Stock Exchange ("TASE"), and, in 1997, began trading through American Depositary Shares ("ADSs") under the symbol "FORTY" on the NASDAQ Global Market in the United States until January 3, 2011, at which date the listing of a. Formula's ADSs was transferred to the NASDAQ Global Select Market ("NASDAQ"). Each ADS represents one ordinary share of Formula. The Company is considered an Israeli resident. As of November, 2010, the controlling shareholder of the Company is Asseco Poland S.A. ("Asseco"), a Polish public company, traded on the Warsaw Stock Exchange.

Formula, through its subsidiaries and affiliates (collectively, the "Company" or the "Group") is engaged in providing proprietary and non-proprietary software solutions and services, software product marketing and support, Computer infrastructure and integration solutions and learning and integration. The Group operates through three directly held subsidiary and affiliated companies: Matrix IT Ltd. ("Matrix"); Magic Software Enterprises Ltd. ("Magic") and Sapiens International Corporation N.V ("Sapiens").

On August 21, 2011, following the acquisition by Sapiens of all of the outstanding shares of FIS Software Ltd. and its subsidiaries ("FIS") and IDIT I.D.I. Technologies Ltd. ("IDIT") (see Note 3a for further information), which was mainly financed by the issuance of Sapiens common shares, Formula's interest in Sapiens was diluted from 75.6% to 42.2%. Formula's investment in Sapiens following the dilution was measured under the equity method of accounting. The gain recognized in 2011 in relation of the Company's loss of control in Sapiens amounted to \$ 25,833 and is presented in the income statement as equity in gains of affiliated companies, net. By December 31, 2011, Formula's interest in Sapiens outstanding common shares increased to 47.3%.

On January 27, 2012, Formula consummated the purchase of Sapiens common shares from two former shareholders of FIS and IDIT (Sapiens' recently acquired companies) and others, resulting in an increase in Formula's interest in Sapiens' outstanding common shares from 47.3% to 52.1%, following which Formula regained control over Sapiens. As a result, a gain in an amount of \$3,410 was recorded during 2012 and is presented in the income statement as

equity in gains of affiliated companies, net (see additional information in note 3a).

On November 19, 2013, Sapiens completed a follow-on public offering of its ordinary shares on the NASDAQ. Sapiens issued 6,497,400 shares at a price of \$ 6.25 per share before issuance expenses. Total net proceeds from the issuance amounted to approximately \$ 37,791. As a result of the offering, Formula's interest in Sapiens' outstanding common shares diluted from 56.8% to 48.6%. Formula's investment in Sapiens following the dilution was measured under the equity method of accounting due to loss of control in Sapiens in accordance with ASC 810. The gain recognized in relation of Formula loss of control in Sapiens amounted to \$ 61,164 and is presented in the income statement as equity in gains of affiliated companies, net (see additional information in note 3a).

F-16

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**NOTE 1:- GENERAL (Cont.)**

On March 5, 2014, Magic completed a follow-on public offering of its ordinary shares on the NASDAQ. Magic issued 6,900,000 shares at a price of \$ 8.50 per share before issuance expenses. Total net proceeds from the issuance, is expected to amount to approximately \$ 54,731. As a result of the offering, Formula's interest in Magic's outstanding common shares diluted from 51.6% to 45.0% (see Note 18).

For a description of the Company's operations, see Note 17f.

The following table presents certain information regarding the control and ownership of Formula's significant b. subsidiaries and affiliates, as of the dates indicated (the list consists only of active companies that are held directly by Formula):

<u>Name of subsidiary (affiliate)</u>	Percentage of ownership and control December 31,	
	2012	2013
Matrix	50.1	50.1
Magic	52.3	51.6
Sapiens*	56.6	48.6

\*) From August 21, 2011 until January 27, 2012, and from November 19, 2013 until December 31, 2013 Sapiens' results of operations were reflected in the Company's results of operations using the equity method of accounting.



**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES**

a. The consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles ("U.S. GAAP"), applied on a consistent basis, as follows:

b. **Use of estimates**

The preparation of the consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported and disclosed in the financial statements and accompanying notes. The Company's management believes that the estimates, judgments and assumptions used are reasonable based upon information available at the time they are made. The most significant assumptions are employed in estimates used in determining values of goodwill and identifiable intangible assets and their subsequent impairment analysis, revenue recognition, tax assets and tax positions, legal contingencies, research and development capitalization, contingent consideration related to acquisitions, classification of leases, determining the fair value of redeemable non-controlling interests and stock-based compensation costs. Actual results could differ from those estimates.

c. **Financial statements in United States dollars**

The currency of the primary economic environment in which the operations of Formula and certain of its subsidiaries are conducted is the U.S. dollar (the "dollar"); thus, the dollar is the functional currency of Formula and certain subsidiaries.

Formula's and certain subsidiaries' transactions and balances denominated in dollars are presented at their original amounts. Monetary accounts maintained in currencies other than the dollar are remeasured into dollars in accordance with the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 830, "Foreign Currency Matters". All transaction gains and losses of the remeasurement of monetary balance sheet items are

reflected in the statements of income as financial income or expenses, as appropriate.

For those subsidiaries whose functional currency is not the dollar, all balance sheet amounts have been translated using the exchange rates in effect at each balance sheet date. Statement of income amounts have been translated using the average exchange rate prevailing during each year. Such translation adjustments are reported as a component of other comprehensive income (loss) in equity.

d.

**Principles of consolidation**

The consolidated financial statements include the accounts of Formula as well as those of its subsidiaries in which it has controlling interests. Intercompany balances and transactions, including profit from intercompany sales not yet realized outside the Group, have been eliminated upon consolidation.

F-18

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES**

Changes in the parents' ownership interest in a subsidiary with no change of control are treated as equity transactions, with any difference between the amount of consideration paid and the change in the carrying amount of the non-controlling interest, recognized in equity.

A change in the parents' ownership interest in a subsidiary that causes a loss of control results in a deconsolidation of the subsidiary. Gain or loss is recognized upon the deconsolidation of a subsidiary, as the difference between (1) the sum of the fair value of any consideration received, the fair value of any retained non-controlling investment in the former subsidiary at the date the subsidiary is deconsolidated, and the carrying amount of any non-controlling interest in the former subsidiary (including any accumulated other comprehensive income attributable to the non-controlling interest) at the date the subsidiary is deconsolidated, and (2) the carrying amount of the former subsidiary's assets and liabilities.

Non-controlling interests in subsidiaries represent the non-controlling share of the total comprehensive income (loss) of the subsidiaries and fair value of the net assets upon the acquisition of the subsidiaries. The non-controlling interests are presented in equity separately from the equity attributable to the equity holders of the Company. Redeemable non-controlling interests are classified as mezzanine, separate from permanent equity, on the consolidated balance sheets and measured at each reporting period at the higher of their redemption amount or the Non-controlling interest book value, in accordance with the requirements of ASC 810 "Consolidation" and ASC 480-10-S99-3A, "Distinguishing Liabilities from Equity".

The following table provides a reconciliation of the redeemable non-controlling interests:

January 1, 2013	\$22,117
Net income attributable to redeemable non-controlling interests	261

Foreign currency translation adjustments	1,151
December 31, 2013	\$23,529

e. **Cash and cash equivalents**

Cash and cash equivalents are short-term highly liquid investments that are readily convertible to cash with original maturities of three months or less, at the date acquired. Cash and cash equivalent includes amounts held primarily in New-Israeli Shekel, U.S. dollars, Euro and British Pound.

F-19

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES**

f. **Short-term and restricted deposits**

Short-term deposits include deposits with original maturities of more than three months and less than one year. Such deposits are presented at cost (including accrued interest) which approximates their fair value. Restricted deposits include deposits used to secure certain subsidiaries' ongoing projects and credit lines from banks as well as, security deposits with respect to leases. Restricted deposits are classified on the Company's consolidated balance sheets as other receivables. On December 31, 2013, the Company maintained a balance of \$289 of restricted deposits.

g. **Marketable securities**

The Company accounts for investments in marketable securities in accordance with ASC 320, "Investments - Debt and Equity Securities." Management determines the appropriate classification of its investments in marketable debt and equity securities at the time of purchase and reevaluates such determinations at each balance sheet date. Debt and equity securities are classified as available-for-sale or as trading and reported at fair value. Unrealized gains and losses from marketable securities classified as "available for sale" are excluded from earnings and are reported as a component in equity under "accumulated other comprehensive income (loss)." Realized gains and losses on sales of investments, as determined on a specific identification basis, are included in financial income, net, together with accretion (amortization) of discount (premium), and interest or dividends.

The Company recognizes an impairment charge when a decline in the fair value of an investment that falls below the cost basis is determined to be other-than-temporary. Declines in fair value of available-for-sale equity securities that are considered other-than-temporary, based on criteria described in Staff Accounting Bulletin ("SAB") Topic 5M, "Other Than Temporary Impairment of Certain Investments in Equity Securities," are charged to earnings (based on the entire difference between fair value and amortized cost). Factors considered in making such a determination include the duration and severity of the impairment, the financial condition and near-term prospects of the issuer of the securities, and the intent and ability of the Company to retain its investment for a period of time that is sufficient to

allow for any anticipated recovery in market value. During 2011, 2012 and 2013, \$514, \$ 700 and \$ 0 of other-than-temporary impairment on equity marketable securities were recorded, respectively. See further details in Note 4.

For declines in value of debt securities, the Company applies an amendment to ASC 320. Under the amended impairment model, an-other-than-temporary impairment loss is deemed to exist and is recognized in earnings if the Company intends to sell or if it is more likely than not that it will be required to sell, a debt security, before recovery of its amortized cost basis. If the criteria mentioned above do not exist, the Company evaluates the collectability of the security in order to determine if the security is other than temporarily impaired.

F-20

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

For debt securities that are deemed other-than-temporarily impaired, the amount of impairment recognized in the statements of income is limited to the amount related to "credit losses" (the difference between the amortized cost of the security and the present value of the cash flows expected to be collected), while impairment related to other factors is recognized in other comprehensive income.

During 2011, 2012 and 2013, the company recorded other-than-temporary impairment on debt marketable securities amounting to \$ 200, \$ 0 and \$ 0, respectively. See further details in Note 4. As of December 31, 2012 and 2013 there were no other than temporary losses in other comprehensive income related to non-credit loss factors.

Unrealized gains and losses from marketable securities classified as "trading" are reported in the consolidated statements of income.

**h. Inventories**

Inventories are mainly comprised of purchased merchandise and products which consist of educational software kits, computers, peripheral equipment and spare parts. Inventories are valued at the lower of cost or market value. Cost is determined on the "first in - first out" basis. The Group periodically evaluates the condition and age of inventories and makes provisions for impairment of slow moving inventories accordingly. No such impairments have been recognized in any period presented.

**i. Investments in affiliates**

Affiliates are companies in which the Group has significant influence over the financial and operating policies without having control and that are not subsidiaries. The Group's investment therein is accounted for in the consolidated financial statements of the Group using the equity method.

Under the equity method, the investment in the affiliate is presented at cost with the addition of post-acquisition changes in the Group's share of net assets, including other comprehensive income of the affiliate. Profits and losses resulting from transactions between the Group and the affiliate are eliminated to the extent of the interest in the affiliate. The equity method is applied until the loss of significant influence or classification as an asset held-for-sale.

Management evaluates investments in equity investees, for evidence of other-than-temporary declines in value. Such evaluation is dependent on the specific facts and circumstances. Accordingly, in determining whether other-than-temporary declines exist, management evaluates various indicators for other-than-temporary declines and evaluates financial information (e.g. Share price in the market, budgets, business plans, financial statements, etc.). During 2013, no impairment loss was recognized.

The financial statements of the Company and of the affiliate are prepared as of the same dates and periods. The accounting policies applied in the financial statements of the affiliate are uniform and consistent with the policies applied in the financial statements of the Company.

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

Losses of an affiliate in amounts which exceed its equity are recognized by the Group to the extent of its investment in the affiliate plus any losses that the Group may incur as a result of a guarantee or other financial support provided in respect of the affiliate. For this purpose, the investment includes long-term receivables (such as loans granted) for which settlement is neither planned nor likely to occur in the foreseeable future.

j. **Property, plant and equipment, net**

Property, plant and equipment are stated at cost, net of accumulated depreciation. Depreciation is calculated by the straight-line method over the estimated useful lives of the assets at the following annual rates:

	%
Computers and peripheral equipment	7-33 (mainly 33%)
Motor vehicles	14-15
Buildings	2-4
Leasehold improvements	Over the shorter of the lease term or useful economic life

k. **Research and development costs**

Research and development costs incurred in the process of software development before establishment of technological feasibility are charged to expenses as incurred. Costs incurred subsequent to the establishment of technological feasibility are capitalized according to the principles set forth in ASC 985-20, "Costs of Software to be Sold, Leased or Marketed."

The Group's technological feasibility is established upon completion of a detailed program design or working model.

Research and development costs incurred in the process of developing product enhancements are generally charged to expenses as incurred.

Capitalized software costs are amortized on a product by product basis by the straight-line method over the estimated useful life of the software product (between 3-7 years). The Group assesses the recoverability of its intangible assets on a regular basis by determining whether the amortization of the asset over its remaining economical useful life can be recovered through undiscounted future operating cash flows from the specific software product sold. During the years ended December 31, 2011, 2012 and 2013, no unrecoverable amounts were identified.

During the years ended December 31 2011, 2012 and 2013, capitalized software development costs of consolidated subsidiaries aggregated to approximately \$ 8,300, \$ 8,433 and \$9,606, respectively, and amortized capitalized software development costs of consolidated subsidiaries aggregated to \$ 6,300, \$ 8,100 and \$8,495, respectively.

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

1. **Other intangible assets**

Other intangible assets are comprised mainly of customer-related intangible assets, backlogs, brand names, capitalized courses development costs and acquired technology, and are amortized over their economic useful lives using a method of amortization that reflects the pattern in which the economic benefits of the intangible assets are consumed or otherwise used up. The useful life of intangible assets is as follows

	Years
Customer relationship and acquired technology	3-15
Capitalized courses development costs	3
Brand names	5
Other intangibles	2-10

m. **Impairment of long-lived assets and intangible assets subject to amortization**

The Group's long-lived assets are reviewed for impairment in accordance with ASC 360, "Property, Plant and Equipment" whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of an asset to be held and used is measured by a comparison of the carrying amount of the asset to the future undiscounted cash flows expected to be generated by the asset. If such asset is considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds the fair value of the asset.

As required by ASC 820, "Fair Value Measurements and disclosures" the Company applies assumptions that marketplace participants would consider in determining the fair value of long-lived assets (or asset groups).

Intangible assets with finite lives are amortized over their economic useful life using a method of amortization that reflects the pattern in which the economic benefits of the intangible assets are consumed or otherwise used up. For example, distribution rights, brand names, capitalized courses development costs, acquired technology and non-compete were amortized on a straight line basis and customer relationships and backlog were amortized on an accelerated method basis over a period between 3.5 - 15 years based on the intangible assets identified.

During each of the years ended December 31, 2011, 2012 and 2013, no impairment was identified.

n.

### **Goodwill**

Goodwill represents the excess of the purchase price in a business combination over the fair value of the net tangible and intangible assets acquired. Under ASC 350, "Intangibles-Goodwill and Other," goodwill is subject to an annual impairment test or more frequently if impairment indicators are present. Goodwill impairment is deemed to exist if the net book value of a reporting unit exceeds its estimated fair value. As of December 31, 2012, the Company operated through 8 reporting units.

F-23

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

As of December 31, 2013, and following Sapiens deconsolidation on November 19, 2013, the Company operated through 6 reporting units.

For the Company's 2011 annual impairment test and as required by ASC 350, the Company compared the fair value of each of its reporting units to its carrying value ('step 1'). If the fair value exceeded the carrying value of the reporting unit net assets, goodwill was considered not impaired, and no further testing is required. If the carrying value exceeded the fair value of the reporting unit, then the implied fair value of goodwill was determined by subtracting the fair value of all the identifiable net assets from the fair value of the reporting unit. An impairment loss was recorded in an amount of the excess, if any, of the carrying value of goodwill over its implied fair value ('step 2').

As required by ASC 820, "Fair Value Measurements and Disclosures", the Company applies assumptions that marketplace participants would consider in determining the fair value of each reporting unit.

As of December 31, 2011, the estimated fair values of the Company's reporting units ranged from 10% to 28%, above their carrying values, thereby obviating the need to proceed to step 2 of the goodwill impairment test under ASC 350.

In September 2011, the FASB issued Accounting Standards Update ("ASU") 2011-08 which amends the rules for testing goodwill for impairment. Under the new rules, an entity has the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary.

The Company adopted the provisions of ASU 2011 for all its reporting units, in its annual impairment test in 2012 and 2013. This analysis determines that no indicators of impairment existed primarily because (1) the Company's market capitalization was consistently substantially in excess of its book value, (2) the Company's overall financial performance has been stable or improving since its respective acquisitions, and (3) forecasts of operating income and cash flows generated by the Company's reporting units appear sufficient to support the book values of the net assets of each reporting unit.

For the reporting units which the performance of the two step impairment test was required, the Company performed the annual impairment tests during the fourth quarter of each of 2011, 2012 and 2013 resulting in no impairment losses for any of the Company's reporting units.

F-24

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

**o. Business combinations**

The Company accounts for business combinations under ASC 805, "Business Combinations." ASC 805 requires recognition of assets acquired, liabilities assumed, non-controlling interest and redeemable non-controlling interest in the acquiree at the acquisition date, measured at their fair values as of that date. As required by ASC 820, "Fair Value Measurements and disclosures" the Company applies assumptions that marketplace participants would consider in determining the fair value of assets acquired, liabilities assumed, non-controlling interest and redeemable non-controlling interest in the acquiree at the acquisition date. Any excess of the fair value of net assets acquired over purchase price and any subsequent changes in estimated contingencies are to be recorded in earnings.

**p. Variable interest entities**

ASC 810, "Consolidation" provides a framework for identifying Variable Interest Entities ("VIEs") and determining when a company should include the assets, liabilities, non-controlling interests and results of activities of a VIE in its consolidated financial statements.

The Company's assessment of whether an entity is a VIE and the determination of the primary beneficiary requires judgment and involves the use of significant estimates and assumptions. Those include, among others, forecasted cash flows, their respective probabilities and the economic value of certain preference rights. In addition, such assessment also involves estimates of whether a group entity can finance its current activities, until it reaches profitability, without additional subordinated financial support.

Effective as of January 1, 2010, the Company applies updated guidance for the consolidation of VIEs. This guidance provides for a qualitative approach, based on which an enterprise has both (1) the power to direct the economically

significant activities of the entity and (2) the obligation to absorb losses of, or the right to receive benefits from, the entity that could potentially be significant to the variable interest entity. Determination as to whether an enterprise should consolidate a VIE is required to be performed continuously, due to changes to existing relationships or future transactions that may affect that determination.

One of the Company's U.S. based consulting and staffing services business which was acquired by Magic through one of its wholly owned subsidiaries on January 17, 2010 is considered to be a VIE. Magic is the primary beneficiary of the VIE, as a result of the fact that it holds the power to direct the activities of the acquired business, which significantly impacts its economic performance, and has the right to receive benefits accruing from the acquired business.

F-25

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

q.

**Severance pay**

Formula's and its Israeli subsidiaries' obligations for severance pay with respect to their Israeli employees (for the period for which the employees were not included under Section 14 of Israel's Severance Pay Law, 1963 (the "Severance Pay Law")) is calculated pursuant to the Severance Pay Law based on the most recent salary of the employees multiplied by the number of years of employment as of the balance sheet date, and are presented on an undiscounted basis (referred to as the "Shut Down Method"). Employees are entitled to one month's salary for each year of employment or a portion thereof. The obligation for all of its Israeli employees is covered in part by managers' insurance policies, for which Formula and its Israeli subsidiaries make monthly deposits with insurance policies and pension funds ("the plan assets"). Plan assets comprise of assets held by a long-term employee benefit fund or qualifying insurance policies. Plan assets are not available to the Group's own creditors and cannot be returned directly to the Group. The Plan assets include profits (losses) accumulated up to the balance sheet date. The Plan assets may be withdrawn only upon the fulfillment of the obligation pursuant to Israel's Severance Pay Law or employment agreements. The value of the Plan assets is based on the cash-surrendered value of these policies and is recorded as an asset on the Company's consolidated balance sheets.

Formula's and its Israeli subsidiaries' defined with certain of their Israeli employees contribution plans pursuant to Section 14 of the Severance Pay Law., under which they pay fixed contributions and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient amounts to pay all employee benefits relating to employee service in the current and prior periods. Contributions to the defined contribution plan in respect of severance or retirement pay are recognized as an expense when contributed concurrently with performance of the employee's services. Deposits under Section 14 are not recorded as an asset on the Company's balance sheet.

Total expenses in respect of severance pay for the years 2011, 2012 and 2013 were \$ 1,391, \$ 3,264 and \$ 3,862, respectively.

r.

### **Revenue Recognition**

The Group derives its revenues primarily from the sale of information technology (or "IT") services which also include: non-proprietary software products, including maintenance, integration and infrastructure, staffing, training and deployment. In addition, the Group generates revenues from licensing the rights to use its proprietary software, provision of related IT professional services (which may or may not be considered essential to the functionality of the software license), related maintenance and technical support, as well as implementation and post-implementation consulting services.

Revenues from IT services are generally recognized in accordance with ASC 605, "Revenue Recognition" and Staff Accounting Bulletin No. 104, "Revenue Recognition in Financial Statements" when IT service is provided and the following criteria are met: persuasive evidence of an arrangement exists, delivery of the product has occurred, the fee is fixed or determinable, and collectability is probable.

Revenues from the sale of products are recognized after all the significant risks and rewards of ownership of the products have been transferred to the buyer, the Group does not retain any continuing management involvement that is associated with ownership and does not retain the effective control of the sold products, the amount of revenues can be measured reliably, it is probable that the economic benefits associated with the transaction will flow to the Group and the costs incurred or to be incurred in respect of the transaction can be measured reliably.

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

Revenues derived from the sale of hardware products and infrastructure solutions are recognized after all the significant risks and rewards of ownership of the products have been transferred to the buyer, the Group does not retain any continuing management involvement that is associated with ownership and does not retain the effective control of the sold products, the amount of revenues can be measured reliably, it is probable that the economic benefits associated with the transaction will flow to the Group and the costs incurred or to be incurred in respect of the transaction can be measured reliably.

Revenues derived from licensing the rights to use software are recognized in accordance with ASC 985-605 "Software Revenue Recognition" when persuasive evidence of an arrangement exists, delivery has occurred, the vendor's fee is fixed or determinable, no further obligation exists and collectability is probable.

Maintenance and support includes annual maintenance contracts providing for unspecified upgrades for new versions and enhancements on a when-and-if-available basis for an annual fee. The right for an unspecified upgrade for new versions and enhancements on a when-and-if-available basis do not specify the features, functionality and release date of future product enhancements for the customer to know what will be made available and the general timeframe in which it will be delivered.

Maintenance and support revenue included in multiple element arrangements is deferred and recognized on a straight-line basis over the term of the maintenance and support agreement.

As required by ASC 985-605, the Group allocates revenues to the software component of its multiple-element arrangements using the residual method when vendor specific objective evidence ("VSOE") of fair value exists for the undelivered elements of the support and maintenance agreements. VSOE is based on the price charged when an element is sold separately or renewed. Under the residual method, the fair value of the undelivered elements is

deferred and the remaining portion of the arrangement fee is allocated to the delivered elements and recognized as revenue.

Revenues from professional services provided on an hourly basis which are not deemed essential to the functionality of the licenses are recognized as the services are rendered.

Revenues from time-and-materials contracts for which the Group is reimbursed for labor hours at fixed hourly billing rates are recognized as revenues as the services are provided.

Certain of the software license sales may also include significant implementation and customization services with respect to such sales which are deemed essential to the functionality of the license. In addition, the Group also provides consulting services that are not deemed essential to the functionality of the license, as well as outsourcing IT services.

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

Revenues from license fees that involve significant implementation and customization of the Group's software to customer specific requirements and which are considered essential to the functionality of the product (for example when the Group sells software licenses as part of an overall solution offered to a customer that combines the sale of software licenses which includes significant implementation that is considered essential to the functionality of the license) are generated by fixed-price or time-and-materials contracts. Revenues generated by fixed-price contracts are recognized in accordance with ASC 605-35 " Construction-Type and Production-Type Contracts" using the percentage-of-completion method. The percentage-of-completion method is used when the required services are quantifiable, based on the estimated number of labor hours necessary to complete the project, and under that method revenues are recognized using labor hours incurred as the measure of progress towards completion.

Estimates of total project requirements are based on prior experience of customization, delivery and acceptance of the same or similar technology, and are reviewed and updated regularly by management. After delivery, if uncertainty exists about customer acceptance of the software, license revenue is not recognized until acceptance. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are first determined, in the amount of the estimated loss on the entire contract. As of each of December 31, 2012 and 2013, no estimated losses were identified.

Revenue from third-party sales is recorded at a gross or net amount according to certain indicators. The application of these indicators for gross and net reporting of revenue depends on the relative facts and circumstances of each sale and requires significant judgment.

The Group generally does not grant a right of return to its customers. When a right of return exists, revenue is deferred until the right of return expires, at which time revenue is recognized, provided that all other revenue recognition criteria are met.

Deferred revenue includes unearned amounts received under maintenance and support contracts and amounts received from customers but not yet recognized as revenues.

s. **Provision for warranty**

The Group records provision for warranty in respect of products and service based on past experience. Amount of warranty provision is immaterial.

t. **Advertising costs**

Expenditures incurred on advertising, marketing or promotional activities, such as production of catalogues and promotional pamphlets, are recognized as an expense when the Group has the right of access to the advertising goods or when the Group receives those services. Advertising costs amounting to \$ 2,500, \$ 2,645 and \$ 2,387 were recorded in the years 2011, 2012 and 2013, respectively.

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

u.

**Income taxes**

Formula and its subsidiaries account for income taxes in accordance with ASC 740, "Income Taxes." This codification prescribes the use of the "liability" method, whereby deferred tax assets and liability account balances are determined based on the differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. Formula and its subsidiaries provide a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value. Deferred tax assets and liabilities are classified as current or non-current according to the expected reversal dates.

Formula and its subsidiaries utilize a two-step approach for recognizing and measuring uncertain tax positions accounted for in accordance with an amendment of ASC 740 "Income Taxes." Under the first step Formula and its subsidiaries evaluate a tax position taken or expected to be taken in a tax return by determining whether the weight of available evidence indicates that it is more likely than not that, based on its technical merits, the tax position will be sustained on audit, including resolution of any related appeals or litigation processes. The second step is to measure the tax benefit as the largest amount that is more than 50% likely to be realized upon ultimate settlement with the tax authorities. The Company accrued interest and penalties related to unrecognized tax benefits in its provisions for income taxes.

v.

**Basic and diluted net earnings per share**

Basic net earnings per share are computed based on the weighted average number of ordinary shares outstanding during each year. Diluted net earnings per share are computed based on the weighted average number of ordinary shares outstanding during each year plus dilutive potential equivalent ordinary shares considered outstanding during the year, in accordance with ASC 260, "Earnings Per Share".

**w. Treasury shares**

In prior years, Formula repurchased its ordinary shares and holds them as treasury shares. These shares are presented as a reduction of equity, at their cost.

x.

**Concentration of credit risk**

Financial instruments that potentially subject the Group to concentrations of credit risk consist principally of cash and cash equivalents, short-term bank deposits, trade receivables, marketable securities and foreign currency derivative contracts. The majority of the Group's cash and cash equivalents, bank deposits and marketable securities are invested with major banks in Israel, the United States and Europe. Such cash and cash equivalents and short-term deposits in the United States may be in excess of insured limits and are not insured in other jurisdictions. Management believes that these financial instruments are held in financial institutions with high credit standing, and accordingly, minimal credit risk exists with respect to these investments.

F-29

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

The Company's marketable securities include investments in commercial and government bonds and foreign banks. The Company's marketable securities are considered to be highly liquid and have a high credit standing. In addition, management considered its portfolios in foreign banks to be well-diversified (also refer to Note 4).

The Group's trade receivables are generally derived from sales to large organizations located mainly in Israel, North America, Europe and Japan. The Group performs ongoing credit evaluations of its customers and has established an allowance for doubtful accounts based upon factors relating to the credit risk of specific customers and other information. In certain circumstances, Formula, its subsidiaries and its affiliates may require letters of credit, other collateral or additional guarantees. From time to time, the Group sells certain of its accounts receivable to financial institutions, within the normal course of business.

The Group maintains an allowance for doubtful accounts receivable based upon management's experience and estimate of collectability of each outstanding invoice. The allowance for doubtful accounts is determined with respect to specific debts that are doubtful of collection. The bad debt expense for the years ended December 31, 2011, 2012 and 2013 was \$ 658, \$ 1,014 and \$ 1,859, respectively. To date, the Company has not experienced any material losses on its accounts receivable. The risk of collection associated with accounts receivable is mitigated by the diversity and number of customers.

The Company transfers financial assets from time to time by factoring of accounts receivable and credit card vouchers to a financial institution. ASC 860, "Transfers and Servicing," establishes a standard for determining when a transfer of financial assets should be accounted for as a sale. Certain underlying conditions must be met for the transfer of financial assets to qualify for accounting as a sale. All sales of receivable were closed during the years and as so there are no outstanding sales of receivables as of December 31, 2011, 2012 and 2013.

The agreements pursuant to which the Company sells its trade receivables are structured such that the Company (i) transfers the proprietary rights in the receivable from the Company to the financial institution; (ii) legally isolates the receivable from the Company's other assets, and presumptively puts the receivable beyond the legal reach of the Company and its creditors, even in bankruptcy or other receivership; (iii) confers on the financial institution the right to pledge or exchange the receivable; and (iv) eliminates the Company's effective control over the receivable, in the sense that the Company is not entitled and shall not be obligated to repurchase the receivable other than in case of failure by the Company to fulfill its commercial obligation.

The Company enters from time to time into foreign exchange forward and option contracts intended to protect against the changes in value of forecasted non-dollar currency cash flows. These derivative instruments are designed to offset a portion of the Company's non-dollar currency exposure (see Note 2z below).

F-30

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

y.

**Stock-based compensation**

The Group accounts for share-based compensation in accordance with ASC 718, "Compensation - Stock Compensation." which requires companies to estimate the fair value of equity-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as an expense over the requisite service periods in the Company's consolidated statements of income. The Company recognizes compensation expenses for the value of its awards, which have graded vesting, based on the straight line method over the requisite service period of each of the awards, net of estimated forfeitures.

Formula, Magic and Sapiens measure and recognize compensation expense for share-based awards based on estimated fair values on the date of grant using the Binomial option-pricing model ("the Binomial model"). Matrix uses the Black-Scholes option-pricing model to measure the fair values of the awards at the date of grant. The Binomial model takes into account variables such as volatility, dividend yield rate, and risk-free interest rate and also allows for the use of dynamic assumptions and considers the contractual term of the option, the probability that the option will be exercised prior to the end of its contractual life, and the probability of termination or retirement of the option holder in computing the value of the option.

Stock based compensation expenses recorded on the subsidiaries' level are presented in non-controlling interests.

The fair value for Formula's subsidiaries' share options granted to employees and directors was estimated using the following weighted-average assumptions:

Magic (the Binomial model):

	Year ended December 31,	
	2011	2013
Dividend yield	0%	3%
Expected volatility	63.3% - 65.3%	57.7%-60.2%
Risk-free interest rate*	2.1%	2.6%
Expected forfeiture (employees)	8.4%	-
Expected forfeiture (executives)	5.2%	5.2%
Contractual term of up to	10 years	10 years
Suboptimal exercise multiple** (employees)	2.7	-
Suboptimal exercise multiple** (executives)	3.2	3.2

\*) The risk-free interest rate is based on the yield from U.S. Treasury zero-coupon bonds that have an equivalent term to the contractual term of the options

The suboptimal exercise factor is the ratio by which the stock price must increase over the exercise price before  
 \*\*) employees are expected to exercise their stock options. This factor is estimated based on employees' historical option exercise behavior.

**FORMULA SYSTEMS (1985) LTD.****AND ITS SUBSIDIARIES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data****NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

In September 2012, the Magic board of directors adopted a dividend distribution policy in accordance to which it will distribute in each year a dividend of up to 50% of its annual distributable profits. Therefore, as of such date Magic uses an expected dividend yield for its new grants. During 2012, there were no grants, nor any modifications in Magic's share options.

Sapiens (the Binomial model):

	<b>Year ended December 31,</b>		
	<b>2011</b>	<b>2012</b>	<b>2013</b>
Contractual life	6 years	6 years	6 years
Expected exercise factor (weighted average)	2.5	2.8	1.5-2
Dividend yield	0%	0%	0%
Expected volatility (weighted average)	70%	60%	54.29%
Risk-free interest rate	0.1%-1.2%	0.2%-1.0%	1.52%

The risk-free interest rate assumption is based on the yield from U.S. Treasury zero-coupon bonds with an equivalent term as of the Sapiens' employee stock options. Since dividend payment is applied to reduce the exercise price of the option, the effect of the dividend protection is reflected by using an expected dividend assumption of zero. The expected life of options granted is derived from the output of the option valuation model and represents the period of time the options are expected to be outstanding. The expected exercise factor is based on industry acceptable rates since no actual historical behavior by option holders exists. Expected volatility is based on the historical volatility of the Sapiens share price.

Matrix (Black-Scholes option-pricing model):

There were no grants by Matrix during 2012 and 2013. During 2011, Matrix granted 2,250,000 options. The fair value of those options was estimated by using the following assumptions under the Black-Scholes model:

**Year ended  
December 31,  
2011**

Expected term (years)	4.6
Dividend yield	0%
Expected volatility	36.5%
Risk-free interest rate	4.3%

For grants to Formula's employees - see Note 12.

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

z.

**Derivatives instruments**

A material portion of the Group's revenues, expenses and earnings is exposed to changes in foreign exchange rates. Depending on market conditions, foreign exchange risk is also managed through the use of derivative financial instruments. These financial instruments serve to protect net income against the impact of the translation into U.S. dollars of certain foreign exchange-denominated transactions.

The derivative instruments primarily hedge or offset exposures to Euro, Japanese Yen and New Israeli Shekel ("NIS") exchange rate fluctuations.

ASC 815, "Derivatives and Hedging," requires companies to recognize all of their derivative instruments as either assets or liabilities in their balance sheet at fair value. Derivative instruments that are designated and qualify as hedges of forecasted transactions (i.e., cash flow hedges) are carried at fair value with the effective portion of a derivative's gain or loss recorded in other comprehensive income and subsequently recognized in earnings in the same period or periods in which the hedged forecasted transaction affects earnings. For derivative instruments that are not designated and qualified as hedging instruments, the gains or losses on the derivative instruments are recognized in current earnings during the period of the change in fair values.

The derivative instruments used by Formula and its subsidiaries are designed to reduce the market risk associated with the exposure of its underlying transactions to fluctuations in currency exchange rates.

Magic has instituted a foreign currency cash flow hedging program, in order to hedge against the risk of overall changes in future cash flows. Magic hedges portions of its forecasted expenses denominated in NIS with currency

forward contracts and put and call options. These forward and option contracts are designated as cash flow hedges. Matrix's and Sapiens' transactions, however, did not qualify as hedging instruments under ASC 815, and as such resulted in recognition of gains or losses related to the transactions in current earnings during the period.

For derivative instruments that are designated and qualify as a cash flow hedge (i.e., hedging the exposure to variability in expected future cash flows that is attributable to a particular risk), the effective portion of the gain or loss on the derivative instrument is reported as a component of other comprehensive income and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. The remaining gain or loss on the derivative instrument in excess of the cumulative change in the present value of future cash flows of the hedged item, if any, is recognized in current earnings during the period of change. For derivative instruments not designated as hedging instruments, the gain or loss is recognized in current earnings during the period of change.

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

The notional principal of foreign exchange contracts to purchase NIS with U.S. dollars was \$ 4,119 and none as of December 31, 2012 and 2013, respectively. The notional principal of foreign exchange contracts to purchase NIS with Euros was \$4,106 and none as of December 31, 2012 and 2013, respectively. The notional principal of foreign exchange contracts to purchase U.S. dollars with Japanese Yen was \$1,276 as of December 31, 2012 and none as of December 31, 2013.

At December 31, 2013, the Company did not have any cash flow hedges.

In 2013, 2012 and 2011 the ineffective net gain (loss) and amounts related to derivatives not classified as hedging recognized in the statements income were \$ 139, \$ 245 and \$ 59, respectively.

aa. **Comprehensive income (loss)**

The Company accounts for comprehensive income (loss) in accordance with ASC 220 "Comprehensive Income." This codification establishes standards for the reporting and display of comprehensive income and its components in a full set of general purpose financial statements. Comprehensive income (loss) generally represents all changes in equity during the period except those resulting from investments by, or distributions to, shareholders. The Company determined that its items of other comprehensive income (loss) relate to gain and loss on foreign currency translation adjustments, unrealized gain and loss on derivatives instruments designated as a hedge, and unrealized gain and loss on available-for-sale marketable securities.

ab. **Fair value measurement**

The Company accounts for certain assets and liabilities at fair value under ASC 820, "Fair Value Measurements and Disclosures". Fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability. As a basis for considering such assumptions, ASC 820 establishes a three-tier value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

Level 1 - Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets;

Level 2 - Significant other observable inputs based on market data obtained from sources independent of the reporting entity; and

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

Level 3 - Unobservable inputs which are supported by little or no market activity (for example, cash flow modeling inputs based on assumptions).

The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The Company categorized each of its fair value measurements in one of these three levels of hierarchy. Assets and liabilities measured at fair value on a recurring basis are comprised of marketable securities, foreign currency forward contracts and contingent consideration of acquisitions (see Note 5).

Foreign currency derivative contracts are classified within Level 2 as the valuation inputs are based on quoted prices and market observable data of similar instruments.

The carrying amounts reported in the balance sheet for cash and cash equivalents, short term bank deposits, trade receivables, other accounts receivable, short-term bank credit, trade payables and other accounts payable approximate their fair values due to the short-term maturities of such instruments.

ac.

**Reclassifications**

Certain amounts in prior years' financial statements have been reclassified to conform with the current year's presentation. The reclassification had no effect on previously reported net income, equity or cash flow.

ad.

**Capital lease**

The Group has accounted for its assets which are under a capital lease arrangement in accordance with ASC 840 "Leases.". In order to determine whether to classify a lease as a capital lease or an operating lease, the Group evaluates whether the lease transfers substantially all the risks and benefits incidental to ownership of the leased asset. In this respect, the Group evaluates such criteria as the existence of a bargain purchase option, the lease term in relation to the economic life of the asset and the present value of the minimum lease payments in relation to the fair value of the asset. Accordingly, assets under a capital lease are stated as assets of the Group on the basis of ordinary purchase prices (without the financing component), and depreciated according to the usual depreciation rates applicable to such assets. The lease payments payable in forthcoming years, net of the interest component included in them, are included in liabilities. The interest in respect of such amounts is accrued on a current basis and is charged to earnings.

F-35

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

ae.

**Recently issued accounting pronouncements**

In July 2013, the Financial Accounting Standards Board ("FASB") issued guidance that requires that a nonrecognized tax benefit be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. This net presentation is required unless a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date or the tax law of the jurisdiction does not require, and the entity does not intend to use, the deferred tax asset to settle any additional income tax that would result from the disallowance of the unrecognized tax benefit. This guidance is effective for fiscal year beginning after December 15, 2013, with early adoption permitted. The Company believes that the adoption of this standard will not have a material impact on its consolidated financial statements.

In February 2013, the FASB issued ASU No. 2013-02, "Reporting of Amounts Reclassified out of Accumulated Other Comprehensive Income." Under ASU 2013-02, an entity is required to provide information about the amounts reclassified out of Accumulated Other Comprehensive Income ("AOCI") by component. In addition, an entity is required to present, either on the face of the financial statements or in the notes, significant amounts reclassified out of AOCI by the respective line items of net income, but only if the amount reclassified is required to be reclassified in its entirety in the same reporting period. For amounts that are not required to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures that provide additional details about those amounts. ASU 2013-02 does not change the current requirements for reporting net income or other comprehensive income in the financial statements. ASU 2013-02 is effective for the Company on January 1, 2013. Since this standard only impacts presentation and disclosure requirements, its adoption did not have a material impact on the Company's consolidated results of operations or financial condition.

In March 2013, the FASB issued further guidance on accounting for the release of a cumulative translation adjustment into net income when a parent company either sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest in a subsidiary or group of assets and provides guidance for the acquisition in stages of a controlling interest in a foreign entity. This guidance is effective for fiscal years beginning after December 15, 2013,

with early adoption permitted. The company believes that the adoption of this standard will not have a material impact on its consolidated financial statements.

F-36

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**NOTE 3:- BUSINESS COMBINATION, SIGNIFICANT TRANSACTION AND SALE OF BUSINESS**

On August 21, 2011 Sapiens acquired all of the outstanding shares of FIS, a provider of packaged-based insurance software solutions for Life and Pension ("L&P"), and IDIT, a provider of insurance software solutions which focuses on the Property & Casualty ("P&C") market. Sapiens financed the acquisition mainly via the issuance of a. Sapiens shares, resulting in a dilution of Formula's interest in Sapiens from 75.6% to 42.2% and the Formula's loss of control of Sapiens, which, in turn, required the deconsolidation of Sapiens' results from the Company's financial statements. Following the loss of control, the Company maintained significant influence over Sapiens, and started using the equity method of accounting on Sapiens results.

Upon the loss of control, in 2011, the Company recognized a gain in an amount of \$ 25,833, which is presented in the income statement as equity in gains of affiliated companies, net. This gain is related to the remeasurement of the retained investment in Sapiens to its fair value. The fair value of the retained investment in Sapiens was measured according to Sapiens' share price on August 21, 2011 of \$4.1 per share.

On January 27, 2012, Formula consummated the purchase of Sapiens common shares from two former shareholders of FIS and IDIT (Sapiens' recently-acquired companies) and other shareholders, resulting in Formula's interest in Sapiens' outstanding common shares increasing from 47.3% to 52.1%, regaining a controlling interest in Sapiens and recording a gain in the amount of \$ 3,410. This gain is related to the remeasurement of the retained investment in Sapiens to its fair value. The fair value of retained investment in Sapiens was measured according to Sapiens' share price on January 27, 2012 of \$4.28 per share.

The acquisition was accounted for using the purchase method. The results of operations of Sapiens have been consolidated commencing as of January 27, 2012.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed, with reference to the acquisition as of January 27, 2012:

Net assets	\$112,536
Customer relationships	5,644
Developed Technology	2,926
Backlog	2,828
OCS liability (See note 14f)	(3,740 )
Deferred tax liability	(1,974 )
Non-controlling interest	(81,605 )
Goodwill	51,614
 Net assets acquired	 \$88,229

In performing the purchase price allocation, management considered, among other factors, analyses of historical financial performance, highest and best use of the acquired assets and estimates of future performance of Sapiens' business. In performing the purchase price allocation, the fair value of intangible assets such as customer relationship was determined based on the income approach and core technology was valued using the relief from royalty method.

**FORMULA SYSTEMS (1985) LTD.****AND ITS SUBSIDIARIES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data****NOTE 3:- BUSINESS COMBINATION, SIGNIFICANT TRANSACTION AND SALE OF BUSINESS (Cont.)**

The following represents the unaudited pro forma condensed results of operations for the years ended December 31, 2011 and 2012, as if Sapiens had been controlled by Formula during the entire period from January 1, 2011, after giving effect to purchase accounting adjustments, including amortization of intangible assets as well as the gains recorded upon the changes in control over Sapiens which occurred during the period. This pro forma financial information is not necessarily indicative of the combined results that would have been attained had the purchase of Sapiens shares taken place at the beginning of 2011, nor is it necessarily indicative of future results.

	Year ended December 31,	
	2011	2012
	Unaudited	
Total revenues	\$ 674,029	\$ 753,392
Net income attributable to Formula Shareholders	\$ 16,233	\$ 21,143
Earnings per share		
Basic	\$ 1.20	\$ 1.57
Diluted	\$ 1.18	\$ 1.51

On November 19, 2013, Sapiens completed a follow-on public offering of its ordinary shares on the NASDAQ. Sapiens issued 6,497,400 shares at a price of \$ 6.25 per share before issuance expenses. Total net proceeds from the issuance amounted to approximately \$ 37,791. As a result of the offering, Formula's interest in Sapiens' outstanding common shares diluted from 56.8% to 48.6% and due to loss of control in Sapiens in accordance with ASC 810, the Company started applying the equity method of accounting to reflect its investment in Sapiens. The gain recognized in relation of Formula's interest in in Sapiens' outstanding common shares, diluting to 48.6%, amounted to \$ 61,164 and is presented in the income statement as equity in gains of affiliated companies, net. The fair value of the retained investment in Sapiens was measured according to Sapiens' share price on November 19, 2013 of \$7.09 per share.

The estimated fair values of the tangible and intangible assets recognized in relation of Formula equity investment in Sapiens are provisional and are based on information that was available as of the date Formula lost control in Sapiens. The Company's management believes the information provides a reasonable basis for estimating the fair values of

these amounts, but is waiting for additional information necessary to finalize those fair values. Therefore, provisional measurements of fair value reflected are subject to change. The Company expects to finalize the tangible and intangible assets valuation as soon as practicable but no later than the measurement period one year from the date of loss of control ("the measurement period").

On December 27, 2011, Magic completed the acquisition of the AppBuilder activity of BluePhoenix Solutions ("AppBuilder"), a leading provider of value-driven legacy IT modernization solutions, for \$12,565. During 2012, the Company paid an additional amount of \$140 with respect to the acquisition. AppBuilder is a comprehensive application development infrastructure used by many enterprises around the world. This premier enterprise application development environment is a powerful, model-driven tool that enables development teams to build, deploy, and maintain large-scale, custom-built business applications.

F-38

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**NOTE 3:- BUSINESS COMBINATION, SIGNIFICANT TRANSACTION AND SALE OF BUSINESS (Cont.)**

The acquisition was accounted for via the purchase method. The results of operations were included in the consolidated financial statements of the Company commencing on January 1, 2012.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed:

Net liabilities	\$(3,248 )
Intangible assets	7,251
Goodwill	8,702

Net assets acquired \$12,705

Identifiable intangible assets, including customer relationships were valued using a variation of the income approach. This method utilized a forecast of expected cash inflows, cash outflows and contributory charges for economic returns on tangible and intangible assets employed.

Amounts of \$ 4,430, \$ 2,138 and \$ 683 of the purchase price were allocated to customer relationships, developed technology and backlog, respectively. The Company amortizes the customer relationships, backlog and acquired technology over periods of 15 years, 15 years and 3.5 years, respectively.

c. In 2011, the Company's subsidiaries, Matrix and Magic, completed the acquisition of additional activities for an aggregate total consideration of up to \$ 21,463, of which as of December 31, 2012 and 2013 the liability with respect to the purchase of these acquisitions amounted approximately \$ 1,250 and \$ 317, respectively.

d.

In January 2012, Matrix purchased from the holders (the "Founders") in AG 2000 Holdings LLC ("the Acquiree") 60% of their interests. The sole asset held by the acquiree was the share capital of Exzac Inc., a U.S. based company in the field of risk management for financial institutions that deals in commerce, and which specializes in application services for enterprise fraud management ("Exzac"). In consideration for the shares, the Company paid the Founders an amount of \$ 6,750, with the addition of approximately \$ 215 for the Acquiree's equity. Moreover, the Founders were entitled to an additional consideration that is contingent on meeting certain targets based on the excess of operating income results over predetermined amount, but in any event not more than \$ 2,500. In accordance with ASC 805-30-35-1, the Company re-measures the contingent consideration based on the fair value at each reporting date until the contingency is resolved or the payment is made, while the changes in fair value are recognized in earnings in the financial expenses using the interest method over the period. The contingent payment was recorded at present value and was amortized using the interest method during the relevant period into financial expenses. As of December 31, 2012 and 2013 the Company's liability towards the sellers is estimated at \$2,360 and \$ 2,420, respectively.

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**NOTE 3:- BUSINESS COMBINATION, SIGNIFICANT TRANSACTION AND SALE OF BUSINESS (Cont.)**

The Company believes that the acquisition of this business will enable it to expand its professional services offering in the U.S and leverage its relationships with top tier customers. Acquisition related costs were immaterial.

Matrix and the Founders received mutual options for the purchase of the founders' remaining shares in the Acquiree. As a result of the mutual options provided, the Company recorded a redeemable non-controlling interest in an amount of \$ 17,706.

On December 19, 2012, the option was partially exercised and Matrix purchased from one of the Founders its shares in the Acquiree (20% of the Acquiree's shares) in consideration of \$ 5,000 and with an additional consideration that will be calculated according to a formula based on the Acquiree's results in 2014. As of December 31, 2013, the outstanding liability regarding the additional consideration approximates \$ 3,355.

The option for purchasing the remaining 20% in the Acquiree, which was measured in approximately \$ 8,355 as of December 31, 2013, was exercised after the Balance Sheet date (On January 5, 2014) in consideration of \$ 5,000 and with an additional amount that will be calculated according to a predetermined formula based on the Acquiree's results in 2014. As a result of this exercise, as of January 5, 2014 the Company will hold 100% in Exzac.

The acquisition was accounted for by the purchase method. The results of operations were included in the consolidated financial statements of the Company commencing as of January 2, 2012.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed, with reference to the acquisition as of January 2, 2012:

Net assets	\$267
Customer relationships	3,195
Backlog and non-compete agreement	338
Redeemable non-controlling interest	(17,706)
Goodwill	23,156
Net assets acquired	\$9,250

Identifiable intangible assets, including customer relationship were valued using a variation of the income approach. This method utilized a forecast of expected cash inflows, cash outflows and contributory charges for economic returns on tangible and intangible assets employed.

Amounts of \$ 3,195 and \$ 338 of the purchase price were allocated to customer relationships and the backlog and non-compete agreements, respectively. The Company amortizes the customer relationships and backlog and non-compete agreement over periods of 4-5 years and 1-3 years, respectively.

F-40

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**NOTE 3:- BUSINESS COMBINATION, SIGNIFICANT TRANSACTION AND SALE OF BUSINESS (Cont.)**

In July 2012, Magic acquired an 80% interest in Comm-IT Group, (including "Comm-IT Technology Solutions" and "Comm-IT Software"), a software and systems development house that specializes in providing advanced IT and communications services and solutions, for a total consideration of \$ 8,933, of which \$ 4,990 was paid upon closing and the remaining \$ 3,943 is to be paid during the next two years, of which, \$ 1,192 is contingent upon the acquired business meeting certain operational targets in 2012 and 2013, and \$ 2,751 in deferred payments. The Purchaser (Magic) and the seller hold mutual call and put options respectively for the remaining 20% interest. As a result of the put option, the Company recorded a redeemable non-controlling interest in an amount of \$ 1,750.

As of December 31, 2012 and 2013 the Company's liability towards the sellers is estimated at \$ 4,031 and \$1,522 respectively. The Company believes that the acquisition of this business will enable it to expand its professional services offering and leverage its relationships with top tier customers. Acquisition related costs were immaterial.

In accordance with ASC 805-30-35-1, the Company re-measures the contingent consideration based on the fair value at each reporting date until the contingency is resolved or the payment is made, while the changes in fair value are recognized in earnings in the financial expenses using the interest method over the period. The contingent payment was recorded at present value and was amortized using the interest method during the relevant period into financial expenses.

The acquisition was accounted for via the purchase method. The results of operations were included in the consolidated financial statements of the Company commencing as of July 1, 2012.

In 2013 the Company finalized the process of identifying the intangible assets for its acquisition. The following table summarizes the fair value of the assets and liabilities acquired:

As reported on December	Adjustment	Modified
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31, 2012

Net assets	\$ 1,219	\$ 14	\$ 1,233
Non-controlling interest	(1,880 )	130	(1,750 )
Intangible assets	3,873	397	4,270
Goodwill	5,809	439	6,248
Deferred tax liability, net	-	(1,068 )	(1,068 )
Net assets acquired	\$ 9,021	\$ (88 )	\$ 8,933

F-41

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**NOTE 3:- BUSINESS COMBINATION, SIGNIFICANT TRANSACTION AND SALE OF BUSINESS (Cont.)**

During the year ended December 31, 2012, Formula and its subsidiaries completed additional two other acquisitions for a total cash consideration of approximately \$10,146 (of which approximately \$ 332 was paid during 2013). The Company allocated \$ 7,085 to goodwill and \$ 2,776 to acquired intangible assets. These acquisitions generally enhance the Group's technologies, and product offerings. Pro forma results of operations for these acquisitions have not been presented because they are not material to the consolidated results of operations, either individually or in the aggregate.

On November 11, 2013, Magic acquired the operations of Allstates Technical Services, LLC, A U.S. based full-service provider of consulting and staffing solutions for IT, Engineering and Telecom personnel, for a total consideration of \$10,963. The Company believed the acquisition will broadens its existing U.S. footprint and adds leading Fortune 500 companies to its customer base, making an important contribution to its growth strategy in the IT professional services operating segment. The results of operations were included in the consolidated financial statements of the Company commencing November 11, 2013.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed as at the acquisition date:

Net assets	\$3,063
Intangible assets	2,874
Goodwill	5,026
Net assets acquired	\$ 10,963

\*) The estimated fair values of the tangible and intangible assets are provisional and are based on information that was available as of the acquisition date to estimate the fair value of these amounts. The Company believes the information provides a reasonable basis for estimating the fair values of these amounts, but is waiting for additional information necessary to finalize those fair values. Therefore, provisional measurements of fair value reflected are subject to change. The Company expects to finalize the tangible and intangible assets valuation and complete the acquisition accounting as soon as practicable as but no later than the measurement period.

During the year ended December 31, 2013, Formula and its subsidiaries completed additional four other acquisitions for a total cash consideration of up to approximately \$8,475, of which \$ 5,919 was attributed to goodwill and \$ h. 1,905 to acquired intangible assets. These acquisitions generally enhance the group's technologies, and product offerings. Pro forma results of operations for these acquisitions have not been presented because they are not material to the consolidated results of operations, either individually or in the aggregate.

F-42

**FORMULA SYSTEMS (1985) LTD.****AND ITS SUBSIDIARIES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data****Note 4:- Marketable securities**

The Group invests in marketable debt and equity securities, which are classified as trading securities and as available-for-sale securities. The following is a summary of marketable securities:

	a.		Composition:
	December 31,		
	2012	2013	
<u>Short-term:</u>			
Trading securities (1)	\$13,976	\$17,102	
Available-for-sale securities	890	854	
Total short-term securities	14,866	17,956	
<u>Long-term:</u>			
Available-for-sale security	331	520	
Total long-term securities	\$331	\$520	

(1) The Company recognized trading gains (losses) in amounts of \$ 957 and \$ 987 during the years ended December 31, 2012 and 2013, respectively.

b. The following is a summary of marketable securities which are classified as available-for-sale:

	December 31,				2013			
	Amortized cost	Unrealized losses	Unrealized Gains	Market value	Amortized cost	Unrealized losses	Unrealized gains	Market Value
Available-for-sale:								

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Government bonds	\$407	\$ -	\$ 20	\$427	\$407	\$ -	\$ 3	\$410
Commercial bonds	192	-	45	237	190	-	25	215
Equity securities	449	-	108	557	450	-	299	749
<u>Total</u> available-for-sale marketable securities	\$1,048	\$ -	\$ 173	\$1,221	\$1,047	\$ -	\$ 327	\$1,374

Out of the unrealized losses as of December 31, 2011, \$ 518, of losses was outstanding over a twelve month period. The fair value of the marketable securities that bore losses over a twelve month period as of December 31, 2011 was \$ 513.

During the years ended December 31, 2011 and 2012 the Company recorded an impairment loss for its investment in equity securities in an amount of \$514 and \$ 700 respectively.

In 2011, 2012 and 2013 the Company received proceeds from sale and maturity of available for-sale marketable securities of \$ 1,507, \$ 2,674 and \$ 0, and recorded related net gains (losses) of \$20, \$ 31 and \$ 0 in financial income, respectively.

**FORMULA SYSTEMS (1985) LTD.****AND ITS SUBSIDIARIES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data****Note 4:- Marketable securities (Cont.)**

The amortized costs of available-for-sale debt securities at December 31, 2013, by contractual maturities, are shown below:

	Amortized cost	Gross unrealized gains (losses)		Estimated fair value
		Gains	Losses	
Due between one year to five years	\$ 597	\$ 28	\$ -	\$ 625
	\$ 597	\$ 28	\$ -	\$ 625

The following is the change in the other comprehensive income from available-for-sale securities during 2013 and 2012:

	Other comprehensive income
Other comprehensive loss from available-for-sale securities as of January 1, 2012	\$ (440 )
Other than temporary impairment on marketable securities	700
Reclassification of earnings of realized gain from available-for-sale	(31 )
Unrealized loss from available-for-sale securities	(56 )
Other comprehensive income from available-for-sale securities as of December 31, 2012	173
Unrealized gain from available-for-sale securities	154
Other comprehensive income from available-for-sale securities as of December 31, 2013	\$ 327

**Note 5: - Fair value measurement**

In determining fair value, the Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible and considers counterparty credit risk in its assessment of fair value.

The Company's financial assets and liabilities measured at fair value on a recurring basis, excluding accrued interest components; consisted of the following types of instruments as of December 31, 2013 and 2012:

F-44

**FORMULA SYSTEMS (1985) LTD.****AND ITS SUBSIDIARIES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data****Note 5: - Fair value measurement (Cont.)**

	Fair value measurements using input type December 31, 2013			
	Level 1	Level 2	Level 3	Total
Assets:				
Equity securities	\$ 4,051	\$ -	\$ -	\$ 4,051
Government and corporate debentures	14,210	215	-	14,425
Foreign currency derivative contracts	-	-	-	-
Total financial assets	18,261	215	-	18,476
Liabilities:				
Contingent consideration (*)	-	-	13,740	13,740
Total financial liabilities	-	-	13,740	13,740
Redeemable non-controlling interest (*)	\$ -	\$ -	\$ 23,529	\$ 23,529

	Fair value measurements using input type December 31, 2012			
	Level 1	Level 2	Level 3	Total
Assets:				
Equity securities	\$ 2,100	\$ -	\$ -	\$ 2,100
Government and corporate debentures	12,860	237	-	13,097
Foreign currency derivative contracts	-	253	-	253
Total financial assets	14,960	490	-	15,450
Liabilities:				
Contingent consideration (*)	-	-	12,022	12,022
Total financial liabilities	-	-	12,022	12,022

Redeemable non-controlling interest (\*) \$ - \$ - \$ 22,117 \$ 22,117

(\*) The fair value of redeemable non-controlling interest and contingent consideration was determined based on the present value of the future expected cash flow.

The following table summarizes the Company's activity with respect to those financial assets where fair value measurements are estimated utilizing Level 3 inputs.

	December 31,	
	2012	2013
Carrying value as of January 1	\$ 2,233	\$ -
Sale of financial assets	(2,331 )	-
Net changes in fair value	67	-
Realized gain	31	-
Carrying value as of December 31	\$ -	\$ -

F-45

**FORMULA SYSTEMS (1985) LTD.****AND ITS SUBSIDIARIES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data****Note 5: - Fair value measurement (Cont.)**

The following table summarizes the activity for those financial liabilities where fair value measurements are estimated utilizing Level 3 inputs:

	December 31,	
	2012	2013
Carrying value as of January 1	\$15,059	\$34,139
Acquisition of new subsidiary	28,209	-
Increase of contingent consideration	-	2,459
Repayment of contingent consideration	(8,907 )	(1,313 )
Exchange differences	177	2,474
Net income attributable to redeemable non-controlling interests	-	546
Net changes in fair value	(399 )	(1,036 )
Carrying value as of December 31	\$34,139	\$37,269

**Note 6:- Investments in affiliated companies**

The following table summarizes activity related to formula's investment in affiliates:

	2013
January 1, 2013	\$1,894
Deconsolidation of Sapiens and accounting for the remaining investment under equity method (see Note 3a)	158,592
Equity in loss of affiliates, net	(481 )
Exchange differences	510
Deferred income	(149 )
Exercise of employees stock options in affiliate	(201 )

December 31, 2013

\$160,165

Following are details relating to the financial position and results of operations of affiliates in the aggregate:

a. Group's share of its associates' statement of financial position based on the interests therein as of the below reporting dates:

	December 31,	
	2012	2013
Current assets	\$1,801	\$50,107
Noncurrent assets (*)	438	136,117
Current liabilities	276	19,005
Noncurrent liabilities	69	7,054
	1,894	160,165
Other investments	1,128	1,336
	\$3,022	\$161,501

(\*) Includes balances of other intangible assets and goodwill in an amount of \$ 398 and \$ 76,553 as of December 31, 2012 and 2013, respectively.

F-46

**FORMULA SYSTEMS (1985) LTD.****AND ITS SUBSIDIARIES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data****Note 6:- Investments in affiliated companies (Cont.)**

Group's share of its associates' statement of operation based on the interests therein during the periods shown below b.(with respect to the Group's interest in Sapiens, for the period from August 21, 2011 until January 27, 2012 and from November 19, 2013 until December 31, 2013 only):

	Year ended December 31,		
	2011	2012	2013
Revenues	\$18,016	\$5,750	\$10,021
Income (loss)	\$(206 )	\$340	\$(481 )

**NOTE 7:- PROPERTY, PLANTS AND EQUIPMENT, NET**

Composition:

	December 31,	
	2012	2013
Cost:		
Computers and equipment	\$31,771	\$21,219
Motor vehicles	641	386
Buildings	3,051	3,281
Leasehold improvements	15,393	15,698
	50,856	40,584
Accumulated depreciation:		
Computers and equipment	21,807	13,230
Motor vehicles	352	182
Buildings	1,683	1,904
Leasehold improvements	5,555	5,860

29,397 21,176

Depreciated cost \$21,459 \$19,408

Depreciation expenses totaled \$ 4,260, \$ 5,500 and \$ 6,241 for the years ended December 31, 2011, 2012 and 2013, respectively.

F-47

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**Note 8:- Goodwill**

The changes in the carrying amount of goodwill for the years ended December 31, 2012 and 2013 were as follows:

Balance as of January 1, 2012	\$ 167,007
Gain of control in subsidiaries	156,381
Adjustments due to finalized purchase price allocation	20
Foreign currency translation adjustments	3,452
Balance as of December 31, 2012	326,860
Gain of control in subsidiaries	11,695
Deconsolidation of a subsidiary	(124,052)
Reclassifications and goodwill adjustment after revaluation of contingent consideration	382
Foreign currency translation adjustments	12,549
Balance as of December 31, 2013	\$ 227,434

The Company performed annual impairment tests during the fourth quarter of 2013 and did not identify any impairment losses (See Note 2n).

**Note 9:- Intangible Assets, Net**

a. Intangible assets, net, are comprised of the following as of the below dates:

	December 31, 2012	2013
Original amounts:		

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Capitalized Software costs	\$83,225	\$68,124
Customer relationship	51,192	39,853
Acquired technology	7,980	3,112
Other intangibles	5,338	5,384

	147,735	116,473
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Accumulated amortization:

Capitalized Software costs	49,776	53,899
Customer relationship	17,609	18,950
Acquired technology	1,575	429
Other intangibles	3,515	3,552

	72,475	76,830
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Total	\$75,260	\$39,643
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F-48

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**Note 9:- Intangible Assets, Net (Cont.)**

Amortized expenses totaled \$ 10,103, \$ 20,150 and \$ 18,108 for the years ended December 31, 2011, 2012 and 2013, respectively.

c. Estimated other intangible assets amortization for the years ended:

December 31,

2014	\$9,581
2015	8,248
2016	6,700
2017	4,122
2018	3,125
2019 and thereafter	7,866
Total	\$39,642

**Note 10:- Liabilities to Banks and Others**

a. Composition:

December 31, 2013	Linkage Basis	Long-term liabilities	Current maturities	Total long-term liabilities net of current maturities	Total long-term liabilities net of current maturities
Interest rate		December 31, 2013			December 31, 2012
%					
3.5-5.9	NIS - Unlinked	\$79,550	\$ 18,972	\$ 60,578	\$ 57,983

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Libor + 4.05%	USD -Unlinked	4,023	4,023	-	4,000
Libor + 3.5%	USD -Unlinked	2,904	1,055	1,849	-
	Other	20	-	20	2,676
Total		\$86,497	\$ 24,050	\$ 62,447	\$ 64,659

b. Maturity dates:

	December 31,	
	2012	2013
First year (current maturities)	\$ 15,667	\$ 24,050
Second year	17,623	22,829
Third year	15,899	16,860
Fourth year	12,049	13,116
Fifth year and thereafter	19,088	9,642
Total	\$ 80,326	\$ 86,497

c. For details of liens, guarantees and credit facilities, see Note 14.

**FORMULA SYSTEMS (1985) LTD.****AND ITS SUBSIDIARIES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data****Note 11:- Debentures**

a. Comprised as follows:

	Linkage	Interest rate	December 31, 2012	December 31, 2013
Non-convertible debentures (b)	CPI	5.15 %	\$15,735	\$ -
Less - current maturities of debentures			(15,735 )	-
Total			\$-	\$ -

b. Non-convertible debentures:

The above-listed non-convertible debentures were issued and sold by Matrix in August 2007 and listed on TASE for trade based on prospectus issued by the Matrix in February 2008. The total issued par value of the debentures as of the issuance date was NIS 250,000 (approximately \$ 62,000).

The debentures bear interest at an annual rate of 5.15% plus additional 0.5% until the debentures were to be listed for trading on the TASE. Interest is paid every six months commencing on December 31, 2007 through December 31, 2013. The principal amount owed under the debentures will be repaid in four equal annual installments on December 31 of each of the years 2010 through 2013 (included). The principal and interest owed under the debentures are linked to the Israeli consumer price index ("CPI"). The effective interest rate of the debentures is 5.21% per annum.

On May 28 2013, Matrix Board of Directors decided on early redemption of the outstanding balance of the debentures. The early redemption payment was made in one installment, at the interest payment date on June 30, 2013 (the "Early Redemption Date"). The amount of actual redemption was approximately NIS 60,752 (approximately \$ 16,792). After the early redemption, the debentures were written off for trading and from the TASE Clearing House.

The amount per NIS 1 par value that the Company redeemed equals to the value of the bonds` liability value, (i.e. principal plus interest and linkage differences to the actual date of early redemption). At December 31, 2013, no debentures are outstanding.

**Note 12:- Employee Option Plans**

In March 2008, Formula's shareholders approved the adoption of Formula's 2008 Employee and Officer Share Option Plan (the "2008 plan"). Pursuant to the 2008 plan, the Company may grant from time to time to the Formula's and its subsidiaries' employees and officers (who are not Formula's controlling shareholders) options to purchase up a. to 400,000 ordinary shares of Formula. The 2008 plan is administered by Formula's board of directors. The 2008 plan provides that options may be granted, from time to time, to such grantees to be determined by the board, at an exercise price and under such terms to be determined at its sole and absolute discretion. Options may be granted under the 2008 plan through January 2018.

F-50

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**Note 12:- Employee Option Plans (Cont.)**

In January 2009, Formula granted to its chief executive officer, in connection with his new service agreement, options to purchase 396,000 ordinary shares. These options vested over a three-year period, commencing on December 17, 2008, on a quarterly basis. The exercise price of the options was NIS 0.01 per share. The options were to expire six years after the date of grant. In April 2010, the Company's chief executive officer exercised all of the options. Total fair value of the grant was calculated based on the Formula share price on the grant date and equaled to \$ 926 (\$ 2.34 per share).

In March 2011, Formula's shareholders approved the adoption of Formula's 2011 Employee and Officer Share Option Plan (the "2011 plan"). Pursuant to the 2011 plan, the Company may grant from time to time to the Company's and its subsidiaries' employees and officers (which are not Formula's controlling shareholders) options to purchase up to 545,000 ordinary shares of Formula. The 2011 plan is administered by Formula's board of directors. The 2011 plan provides that options may be granted, from time to time, to such grantees to be determined by the board, at an exercise price and under such terms to be determined at its sole and absolute discretion. Options may be granted under the plan through March 2021. In 2012, the Company increased the amount of ordinary shares reserved for issuance under the 2011 plan by 1,200,000 options.

In March 2011, concurrently with the amendment and extension of Formula chief executive officer's service agreement, the Company approved him a grant of options exercisable for an additional 543,840 ordinary shares. The options vest in equal quarterly installments, over a four year period that commence in December 31, 2011 and concludes in December 31, 2015. The exercise price of the options is NIS 0.01 per share. In May 2011, the chief executive officer exercised all of these options for redeemable restricted shares, for which the Company's redemption right was to lapse in accordance with the remaining vesting schedule for the unvested options from which they arose. Total fair value of the grant was calculated based on the Formula share price on the grant date and totaled \$ 9,055 (\$ 16.65 per share).

In December 2011, at which time Formula was negotiating an amendment and an extension of its chief executive officer's service agreement, it redeemed all of the above-described 543,840 shares for no consideration.

F-51

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**Note 12:- Employee Option Plans (Cont.)**

In March 2012, concurrently with the amendment and extension of its chief executive officer's service agreement, the board of directors of Formula awarded him with a new share option incentive plan, following the redemption of the 543,840 redeemable ordinary shares which were granted to him in March 2011 and which were not yet vested in their redemption date. Under the 2011 plan, the chief executive officer of Formula was granted with options exercisable to 1,122,782 ordinary shares of Formula (the "New grant"), as long as he continue to serve as (i) a director of Formula and/or (ii) a director of each of the directly held subsidiaries of Formula; provided that if he fails to meet the foregoing requirement (A) due to the request of the board of directors of either Formula or any of its directly held subsidiaries (other than a request which is based on actions or omissions by the chief executive officer that would constitute "cause" under his service agreement with Formula), (B) because the chief executive officer is prohibited under the governing law or charter documents of the relevant company or the stock exchange rules and regulations applicable to such company from being a director of such company (other than due to his actions or omissions) or (C) notwithstanding the chief executive officer's willingness to be so appointed (but provided that neither (A) nor (B) applies); then, in each of (A), (B) and (C), the chief executive officer will be deemed to have complied with clauses (i) or (ii) above. The options vest, i.e., Formula's redemption right with respect to the options and the underlying ordinary shares issuable upon exercise lapses, in equal quarterly installments over an eight year period that commenced in March 2012 and concludes in December 31, 2019. The exercise price of the options is NIS 0.01 per share. The New grant is accounted for as a modification to the March 2011 grant to the chief executive officer. Total fair value of the grant was calculated based on the share price on the grant date and totaled \$ 18,347 (\$ 16.34 per share).

In accordance with the terms of the option grant, the shares issuable upon exercise of the options will be deposited with a trustee and Formula chief executive officer will not be permitted to vote or dispose of them until the shares are released from the trust.

In June 2013 all options were exercised into shares however they have been deposited with a trustee and Formula's chief executive officer is not permitted to vote or dispose of them until the shares are released from the trust. All shares participate in dividends and have the right to vote, however for so long as the shares are held by the trustee (even if they have vested) the voting rights may only be exercised by the trustee. In accordance with the guidelines of Formula incentive plan for so long as the shares underlying any grant under the plan are being held by the trustee they will be voted by the trustee in the same proportion as the results of the shareholder meeting. Only those shares for which the vesting period has expired may be collected from the trustee. As of December 31, 2013 all 1,122,782 shares

were deposited with the trustee.

Formula's subsidiaries grant, from time to time, options to their employees to purchase shares in the respective companies. The options were mainly granted during the years 1999-2011. In general, the options expire 7-10 years after grant. For further information with respect to expenses relating to the benefit to the employees, an additional disclosure required by ASC 718, see Note 2y.

The following table sets forth the breakdown of stock-based compensation expense resulting from stock options grants, as included in the consolidated statements of income:

	Year ended December 31,		
	2011	2012	2013
Cost of revenues	\$4	\$16	\$11
Research and development expenses	54	114	67
Selling and marketing expenses	92	82	86
General and administrative expenses	4,473	4,708	3,814
Total stock-based compensation expense	\$4,623	\$4,920	\$3,978

F-52

**FORMULA SYSTEMS (1985) LTD.****AND ITS SUBSIDIARIES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data****Note 12:- Employee Option Plans (Cont.)**Magic:

The following table is a summary of employee option activity as of December 31, 2013, and changes during the year ended December 31, 2013, in Magic:

	Number of options	Weighted average exercise price	Weighted average remaining contractual term (in years)	Aggregate intrinsic value
Outstanding at January 1, 2013	1,157,385	\$ 2.74	5.87	\$ 2,298
Granted	85,000	\$ 6.00		
Exercised	(528,627 )	\$ 2.73		
Expired and forfeited	(10,648 )	\$ 1.51		
Outstanding at December 31, 2013	703,110	\$ 3.16	6.68	\$ 2,822
Exercisable at December 31, 2013	461,610	\$ 2.36	5.78	\$ 2,219
Vested and expected to vest at December 31, 2013	703,110	\$ 3.16	6.68	\$ 2,822

The weighted-average grant-date fair value of options to purchase Magic shares granted during the years ended December 31, 2011 and 2012 was \$ 1.88 \$ 4 and \$ 6, respectively. The aggregate intrinsic value in the table above represents the total intrinsic value that would have been received by the option holders had all option holders exercised their options on December 31, 2013. This value would change based on changes in the market value of Magic's ordinary shares.

The total intrinsic value of Magic options exercised during the years ended December 31, 2011, 2012 and 2013 was \$ 2,197, \$ 572 and \$ 1,741, respectively. As of December 31, 2013, there was \$ 423 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under Magic's option plans. This cost is expected to be recognized over a weighted-average period of approximately three years.

F-53

**FORMULA SYSTEMS (1985) LTD.****AND ITS SUBSIDIARIES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data****Note 12:- Employee Option Plans (Cont.)**Matrix:

The following table is a summary of employee option activity as of December 31, 2013, and changes during the year ended December 31, 2013, in Matrix:

	Number of options	Weighted average exercise price	Weighted average remaining contractual term (in years)	Aggregate intrinsic value
Outstanding at January 1, 2013	2,100,000	\$ 3.85	2.80	\$ 976
Granted	-			
Exercised	(75,000 )	0		
Expired and forfeited	-			
Outstanding at December 31, 2013	2,025,000	4.29	1.96	1,671
Exercisable at December 31, 2013	1,050,000	\$ 4.46	1.96	\$ 693

The aggregate intrinsic value in the table above represents the total intrinsic value that would have been received by the option holders had all option holders exercised their options on December 31, 2013. This value would change based on the change in the market value of Matrix' ordinary shares. As of December 31, 2013, there was approximately \$ 105 of total unrecognized compensation costs related to non-vested share-based compensation arrangements granted under Matrix equity incentive plan. Those costs are expected to be recognized over a weighted-average period of twelve months. The total intrinsic value of options exercised during the years ended December 31, 2011, 2012, and 2013 was \$ 738, \$ 376 and \$ 380, respectively.

**Note 13: - Liability in respect of capital lease**

The following are details of the Company's future minimum lease commitments in respect of capital leases as of December 31, 2013:

	Minimum lease payments	Interest	Present value of minimum lease payment
First year	\$ 590	\$ 110	\$ 480
Second year until fifth year	1,547	128	1,419
Total	\$ 2,137	\$ 238	\$ 1,899

F-54

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**Note 14:- Commitments and Contingencies**

a. Liens:

Pursuant to a bank credit agreement, a lien has been incurred by the Company over a certain portion of its investment in outstanding shares of Matrix and Sapiens. As of February 2014 the bank credit was repaid and all liens have been removed - see also note 18.

b. Guarantees:

The Group has provided certain bank guarantees in an aggregate of approximately \$ 14,500 as security for its subsidiary companies' performance of various contracts with customers. If the subsidiaries were to breach certain terms of such contracts, the customers could demand that the banks providing the guarantees distribute the amounts claimed to be due.

Certain subsidiaries have provided bank guarantees aggregating to \$ 4,400 as security for rent to be paid for their offices and credit lines from banks. If such subsidiaries were to breach certain terms of their leases, the lessors could demand that the banks providing the guarantees distribute the amounts claimed to be due.

c. Covenants:

In connection with the Group's credit facility agreements, primarily Matrix, with various financial institutions, the Group committed to the following:

1. To maintain certain financial ratios. The Group has met the financial ratios as of December 31, 2012 and 2013.

2. Matrix committed not to grant a security interest in all or substantially all of its assets.

Matrix committed not to distribute dividends that will cause its equity (when measured based on International Financial Reporting Standards ("IFRS")) to be less than NIS 275,000 (approximately \$ 79,000). As of December 31, 2013, Matrix's equity was approximately NIS 581,000 (approximately \$ 167,000) (as measured based on IFRS).

F-55

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**Note 14:- Commitments and Contingencies (Cont.)**

d. Legal proceedings:

In August 2009, a software company and one of its owners filed an arbitration proceeding against Magic and one of its subsidiaries, claiming an alleged breach of a non-disclosure agreement between the parties. The plaintiffs are seeking damages in an amount of approximately NIS 52,000 (approximately \$ 14,980). The arbitrator determined that both Magic and the subsidiary breached the non-disclosure agreement. The closing summaries regarding damages have been submitted, but the arbitrator has not yet rendered his ruling.

In June 2011 the plaintiffs filed a motion to allow them to amend the claim by adding new causes of action and increasing the damages claimed in the lawsuit by approximately additional NIS 238,000 (approximately \$ 68,568) based on new arguments. Following discussions, the arbitrator rejected the motion and determined that if the plaintiffs wish to claim the additional damages (and the additional causes of action) they should do so in a separate legal proceeding. To date the plaintiffs have not filed an additional lawsuit.

Magic recorded an accrual to cover damages to be awarded, based on the conclusions of the financial expert opinion that was filed by Magic in the arbitration proceedings. At this time, given the multiple uncertainties involved and in large part to the highly speculative nature of the damages sought by the plaintiff, which leaves a wide discretion to the arbitrator in quantifying and awarding the damages, the Company is unable to estimate the amount of the probable loss, if any, to be recognized or whether the accrual will be sufficient to cover the damages that will be awarded.

2. In addition to the above-described legal proceedings, from time to time, Formula and/or its subsidiaries are subject to legal, administrative and regulatory proceedings, claims, demands and investigations in the ordinary course of business, including claims with respect to intellectual property, contracts, employment and other matters. The Company applies ASC 450, "Contingencies," and accrues a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Significant judgment is required in the determination of both the probability and as to whether a loss is reasonably estimable. These accruals are reviewed at least quarterly and adjusted to reflect the impact of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular matter. The Company intends to defend itself vigorously

against the above claims, and it generally intends to vigorously defend any other legal claims to which it is subject. While for most litigation, the outcome is difficult to determine, to the extent that there is a reasonable possibility that the losses to which the Company may be subject could exceed the amounts (if any) that it has already accrued, the Company attempts to estimate such additional loss, if reasonably possible, and disclose it (or, if it is an immaterial amount, indicate accordingly). The aggregate provision that the Company has recorded for all other legal proceedings (other than the particular material proceedings described above) is not material. Furthermore, in respect of its ordinary course legal, administrative and regulatory proceedings (that is, other than the particular material proceedings described above), the Company estimates, in accordance with the procedures described above, that as of the current time there is no reasonable possibility that it will incur material losses exceeding the non-material amounts already recognized.

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**Note 14:- Commitments and Contingencies (Cont.)**

e. Operating lease commitments:

The following are details of the Company's future minimum lease commitments for office equipment, office space and motor vehicles under non-cancelable operating leases as of December 31, 2013:

2014	\$21,585
2015	10,432
2016	9,338
2017	7,856
2018 and Thereafter	5,723
	\$54,934

Rent expenses for the years 2011, 2012 and 2013, were approximately \$ 13,000, \$ 15,559 and \$ 16,107, respectively.

f. Royalty commitments:

Sapiens Technologies (1982) Ltd. ("Sapiens Technologies"), a subsidiary of Sapiens incorporated in Israel, was partially financed under programs sponsored by the Israel's Office of the Chief Scientist ("OCS") for the support of certain research and development activities conducted in Israel. In exchange for participation in the programs by the OCS, Sapiens Technologies agreed to pay 3%-3.5% of total net consolidated license and maintenance revenue and 0.35% of the net consolidated consulting services revenue related to the software developed within the framework of these programs based on an understanding with the OCS reached in January 2012.

The royalties will be paid up to a maximum amount equaling 100%-150% of the grants provided by the OCS, linked to the dollar, and for grants received after January 1, 1999, bear annual interest at a rate based on LIBOR.

Royalty expenses amounted to \$ 340, \$ 574 and \$ 450 in 2011, 2012 and 2013, respectively, and are included in cost of revenues.

F-57

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**Note 15:- Equity**

The composition of the Company's share capital is as follows:

	December 31, 2013		Outstanding	December 31, 2012		Outstanding
	Authorized	Issued		Authorized	Issued	
Ordinary shares, NIS 1 par value each	25,000,000	15,287,402	14,718,782	25,000,000	14,164,620	13,596,000

a. Formula's ordinary shares, par value NIS 1 per share, are traded on the TASE and Formula's ADSs, each representing one ordinary share, are traded on the NASDAQ.

b. Formula holds 568,620 of its ordinary shares.

c. In May 2011, Formula distributed a cash dividend of approximately \$ 10,000 (or \$ 0.71 per share).

d. In July 2013, Formula distributed a cash dividend of approximately \$ 5,446 (\$ 0.37 per share).

e. On December 30, 2013, Formula declared a cash dividend of approximately \$ 4,563 (or \$0.31 per share) to be paid on February 6, 2014.

f. For information concerning Formula employees and officers share option plan, see Note 12.

g. In December 2010, Magic consummated a private placement of its ordinary shares and warrants with several institutional and private investors, issuing 3,287,616 ordinary shares at a price of \$ 6.5 per share and in a total amount of \$ 20,290 net of issuance expenses. In addition, certain of the purchasers received warrants to purchase

up to an aggregate of 1,134,231 Magic ordinary shares at an exercise price of \$ 8.26 per share. The warrants are exercisable as of six months from the date of issuance, have a term of three years, and the exercise price is subject to future adjustment for various events, such as stock splits or dividend distributions.

**Note 16:- Income Taxes**

a. Israeli taxation:

1. Taxable income of Israeli companies is subject to tax at the rate of 24% in 2011, 25% in 2012, 25% in 2013 and 26.5% in 2014 and onwards.

On July 30, 2013, the Israeli Parliament (the Knesset) approved the second and third readings of the Economic Plan for 2013-2014 ("Amended Budget Law") which consists, among others, raising the Israeli corporate tax rate from 25% to 26.5% commencing January 1, 2014.

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**Note 16:- Income Taxes (Cont.)**

2. Tax benefits under the Israeli Law for the Encouragement of Capital Investments, 1959 ("the Law"):

Certain production and development facilities of Formula's Israeli subsidiaries have been granted "Approved Enterprise" and "Privileged Enterprise" status pursuant to the Law, which provides certain tax benefits to its investment programs including

tax exemptions and reduced tax rates. Income not eligible for Approved Enterprise and Privileged Enterprise benefits is taxed at regular rates.

In the event of distribution of dividends from the said tax-exempt income, the amount distributed will be subject to corporate tax at the rate ordinarily applicable to the Approved Enterprise's income. The tax-exempt income attributable to the benefit period of the Approved Enterprise programs mentioned above can be distributed to shareholders without subjecting the Company to taxes, only upon the complete liquidation of the applicable Israeli subsidiary. Tax-exempt income generated under the Privileged Enterprise program will be subject to taxes upon dividend distribution (which includes the repurchase of the Company's shares) or liquidation.

For all the above referred to operations, the benefit periods under the Law have not yet commenced.

The entitlement to the above benefits is conditional upon the fulfillment of the conditions stipulated by the Law and related regulations (see below). Should any of Formula's Israeli subsidiaries fail to meet such requirements in the future, income attributable to the relevant entity's Approved Enterprise or Privileged Enterprise programs could be subject to the statutory Israeli corporate tax rate, and the entity could be required to refund a portion of the tax benefits already received with respect to such programs. As of December 31, 2013, management believes that Formula's Israeli subsidiaries are in compliance with all of the conditions required by the Investment Law.

Effective January 1, 2011, the Israeli Knesset enacted the Law for Economic Policy for 2011 and 2012 (Amended Legislation), and among other things, amended the Law, ("the Amendment"). According to the Amendment, the benefit tracks in the Law were modified and a flat tax rate applies to the Formula's Israeli subsidiaries entire preferred income. These subsidiaries will be able to opt to apply (the waiver is non-recourse) the Amendment and from then on it will be subject to the amended tax rates as follows: 2014 - 16%. As of December 31, 2013, none of Formula's Israeli subsidiaries has applied for this amendment. The profits of these "Industrial Companies" will be freely distributable as dividends, subject to a withholding tax of 20% (on distribution commencing January 1, 2014) or lower, under an applicable tax treaty. Certain "Special Industrial Companies" that meet more stringent criteria (significant investment, R&D or employment thresholds), will enjoy further reduced tax rates of 5% in Zone A and 8% elsewhere. In order to be classified as a "Special Industrial Company," the approval of three governmental authorities in Israel is required.

F-59

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**Note 16:- Income Taxes (Cont.)**

Certain of Formula Israeli subsidiaries intend to apply the new incentives regime under Amendment 68 to its Approved Enterprises in Israel starting in 2014 and believe that they will qualify as an "Industrial Company" under the new law.

3. Tax benefits under the Israeli Law for the Encouragement of Industry (Taxes), 1969:

It is Formula's management belief that some of its Israeli subsidiaries currently qualify as an "Industrial Company," within the meaning of the Law for the Encouragement of Industry (Taxes), 1969 (the "Industrial Encouragement Law"). That Industrial Encouragement Law defines an "Industrial Company" as a company that is resident in Israel and that derives at least 90% of its income in any tax year, other than income from defense loans, capital gains, interest and dividends, from an enterprise whose major activity in a given tax year is industrial production. Under the Industrial Encouragement Law, these Israeli subsidiaries are entitled to amortization of the cost of purchased know-how and patents over an eight-year period for tax purposes as well as accelerated depreciation rates on equipment and buildings.

4. Foreign Exchange Regulations

Under the Foreign Exchange Regulations, some of Formula's Israeli subsidiaries calculate their tax liability in U.S. Dollars according to certain orders. The tax liability, as calculated in U.S. Dollars is translated into NIS according to the exchange rate as of December 31st of each year.

b. Non-Israeli subsidiaries:

Non-Israeli subsidiaries are taxed according to the tax laws in their respective domiciles of residence. None-of Israeli income taxes, foreign withholding taxes nor deferred income taxes has been provided in relation to undistributed

earnings of the non-Israelis subsidiaries. This is because the Company intends to permanently reinvest undistributed earnings in the foreign subsidiaries in which those earnings arose. If these earnings were distributed to Israel in the form of dividends or otherwise, the Company may be subject to additional Israeli income taxes (subject to an adjustment for foreign tax credits) and foreign withholding taxes.

c. Net operating loss carryforwards:

Formula

Formula stand alone had cumulative losses for tax purposes as of December 31, 2013 totaling approximately \$ 68,640 (as of December 31, 2012, the amount was \$ 60,030), which can be carried forward and offset against taxable income in the future for an indefinite period,

F-60

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**Note 16:- Income Taxes (Cont.)**

Matrix

Matrix had cumulative losses for tax purposes as of December 31, 2013 totaling approximately \$ 33,700 (as of December 31, 2012, the amount was \$ 38,100), which can be carried forward and offset against taxable income in the future for an indefinite period,

Magic

As of December 31, 2013, Magic and its Israeli subsidiaries had operating loss carryforwards of \$ 12,412, which can be carried forward and offset against taxable income in the future for an indefinite period. Magic's subsidiaries in Europe had estimated total available tax loss carryforwards of \$ 5,252 as of December 31, 2013, to offset against future taxable income. Magic's subsidiaries in the U.S. had estimated total available tax loss carryforwards of \$ 2,835 as of December 31, 2013, which can be carried forward and offset against taxable income for a period of up to 20 years, from the year the loss was incurred.

Utilization of U.S. net operating losses may be subject to substantial annual limitations due to the "change in ownership" provisions ("annual limitations") of the Internal Revenue Code of 1986 and similar state provisions. The annual limitation may result in the expiration of net operating losses before utilization.

Sapiens

As of December 31, 2013, certain subsidiaries of Sapiens had tax loss carry-forwards totaling approximately \$ 45,912. Most of these carry-forward tax losses have no expiration date.

Formula, its subsidiaries and its affiliates have cumulative losses for tax purposes as of December 31, 2013 totaling approximately \$ 177,211 (as of December 31, 2012, the amount was \$ 188,600), of which \$ 146,927 was in respect of companies in Israel which can be carried forward and offset against taxable income in the future for an indefinite period, and approximately \$ 30,284 of which was in respect of companies abroad (as of December 31, 2012, that amount was \$ 26,000).

In assessing the realization of deferred tax assets, management considers whether it is more likely than not that all or some portion of the deferred tax assets will not be realized. The ultimate realization of the deferred tax assets is dependent upon the generation of future taxable income during the periods in which temporary differences are deductible and net operating losses are utilized. Based on a consideration of these factors, the Company recorded a valuation allowance as detailed in Note 16(e) below.

d. Income tax assessments:

Formula and its subsidiaries are routinely examined by various taxing authorities. Below is a summary of the income tax assessments of Formula, its subsidiaries and its affiliates:

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**Note 16:- Income Taxes (Cont.)**

Formula

Formula's tax years 2009 through 2013 remain subject to examination by the Israeli Tax Authorities.

Matrix

Matrix and its subsidiaries have received final tax assessments (or assessments that are deemed final) through the 2010 and 2009 tax years.

Magic

Magic (the Israeli entity) and its Israeli subsidiaries have received final tax assessments (or assessments that are deemed final) through the year 2008. Non-Israeli subsidiaries of Magic are taxed according to the tax laws in their respective jurisdictions of domicile of residence. If earnings are distributed to Israel in the form of dividends or otherwise, the Company may be subject to additional Israeli income taxes (subject to adjustment for foreign tax credits) and foreign withholding taxes.

Sapiens

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As of December 31, 2013, most of the Sapiens' Israeli subsidiaries are subject to Israeli income tax audits for the tax years 2008 through 2012, to U.S. federal income tax audits for the tax years of 2009 through 2013, and to other for the tax years of 2006 through 2013.

e. Deferred tax assets and liabilities:

1. Composition, net:

	December 31,	
	2012	2013
Net operating losses carried forward	\$44,822	\$32,414
Allowances, reserves and intangible assets	(487 )	3,409
Capitalized software costs	(3,140 )	(1,723 )
Differences in measurement basis (cash basis for tax purposes)	(6,770 )	(6,104 )
	34,425	27,996
Valuation allowance	(25,407)	(20,692)
Total	\$9,018	\$7,304

F-62

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**Note 16:- Income Taxes (Cont.)**

2. Presentation in balance sheets:

	December 31,	
	2012	2013
Other current assets (Note 17c)	\$7,527	\$4,876
Other non-current assets	13,618	13,152
Other current liabilities	(4,143 )	(2,567 )
Long-term liabilities	(7,984 )	(8,157 )
	\$9,018	\$7,304

f. Income before taxes on income:

	Year ended December 31,		
	2011	2012	2013
Domestic	\$32,692	\$37,430	\$47,717
Foreign	10,258	12,893	7,582
Total	\$42,950	\$50,323	\$55,299

g. Income taxes included in the statements of income:

	Year ended December 31,		
	2011	2012	2013
Current taxes:			

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Domestic	\$8,351	\$5,955	\$5,474
Foreign	1,136	1,113	2,526
	9,487	7,068	8,000
Deferred taxes:			
Domestic	(3,948)	(453 )	2,464
Foreign	150	(32 )	(1,538)
Deferred taxes, net	(3,798)	(485 )	926
Taxes on income	\$5,689	\$6,583	\$8,926

F-63

**FORMULA SYSTEMS (1985) LTD.****AND ITS SUBSIDIARIES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data****Note 16:- Income Taxes (Cont.)**

## h. Theoretical tax:

The following table presents reconciliation between the theoretical tax expense, assuming that all income was taxed at statutory tax rates, and the actual income tax expense, as recorded in the Company's statements of income:

	Year ended December 31,					
	2011		2012		2013	
Income before income taxes, as per the statement of operations	\$42,950		\$50,323		\$55,299	
Statutory tax rate in Israel	24	%	25	%	25	%
Theoretical tax expense	10,308		12,581		13,825	
Reconciliation:						
Non-deductible expenses	1,539		1,965		810	
Effect of different tax rates	922		547		813	
Deferred taxes on losses (utilization of losses) and temporary differences for which a valuation allowance was provided, net	883		(761 )		(183 )	
Effect of change in Israel tax rates	(1,606 )		-		(677 )	
Prior year losses and temporary differences for which deferred taxes were recorded, net	(6,692 )		(4,179 )		(1,110 )	
Uncertain tax position	297		(1,260 )		(3,560 )	
Taxes in respect of prior years	(707 )		(2,456 )		(638 )	
Other	745		146		(354 )	
Income taxes as per the statement of operations	\$5,689		\$6,583		\$8,926	
Effective tax rate - in %	13.2	%	13.1	%	16.1	%

**FORMULA SYSTEMS (1985) LTD.****AND ITS SUBSIDIARIES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data****Note 16:- Income Taxes (Cont.)**

## i. Uncertain tax positions:

A reconciliation of the beginning and ending amount of total unrecognized tax benefits in Formula's subsidiaries is as follows:

Balance as of January 1, 2012	\$4,181
Increase due to consolidation of Sapiens	1,566
Increase related to current year tax positions	66
Decrease related to prior years' tax positions	(401 )
Settlements with tax authorities	(925 )
Balance as of December 31, 2012	4,487
Increase due to deconsolidation of Sapiens	(634 )
Increase related to current year tax positions	
Decrease related to prior years' tax positions	(2,836)
Balance as of December 31, 2013	\$1,017

The Group recognizes accrued interest and penalties related to unrecognized tax benefits as a component of income tax expense. For the years ended December 31, 2011, 2012 and 2013, the amounts recognized, on a consolidated basis, for interest and penalties expenses related to uncertain tax positions were \$ (154), \$ 97 and \$ 17, respectively. In addition, the Group's consolidated liability for unrecognized tax benefits including accrued interest and penalties related to uncertain tax positions was \$ 239 and \$ 58 at December 31, 2012 and 2013, respectively, which is included within income tax accrual in the Group's consolidated balance sheets.

As of December 31, 2013, there was no uncertain tax positions for which it was reasonably possible that the total amount of the Group's unrecognized tax benefits would significantly increase or decrease within 12 months.

As of December 31, 2013, the entire amount of unrecognized tax benefit (i.e., \$994) could affect the Group's income tax provision and the effective tax rate.

F-65

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**Note 17:- Supplementary Financial Statement Information**

Balance Sheets:

a. Other accounts receivable and prepaid expenses:

Composition:

	December 31,	
	2012	2013
Government departments	\$17,331	\$14,599
Employees (1)	368	420
Prepaid expenses and advances to suppliers	11,490	13,920
Deferred taxes	7,527	4,876
Restricted deposits	699	289
Other	1,448	505
<b>Total</b>	<b>\$38,863</b>	<b>\$34,609</b>

(1) Some of these balances are linked to the CPI, and bear interest at an annual rate of 4%.

b. Liabilities to Banks:

Composition:

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	December 31, 2013		December 31, 2012	December 31, 2013
	Interest rate %	Linkage basis		
Bank credit	Prime+2%	Unlinked	\$12	\$-
Short-term bank loans	Prime+0.1%		8,502	11,586
Current maturities of long-term loans from banks (see Note 10)			15,093	24,050
Total			\$23,607	\$35,636

F-66

**FORMULA SYSTEMS (1985) LTD.****AND ITS SUBSIDIARIES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data****Note 17: - Supplementary Financial Statement Information (Cont.)**

c. Other accounts payable:

Composition:

	December 31,	
	2012	2013
Government institutions	\$ 14,391	\$ 13,068
Customer advances	917	2,601
Deferred taxes (Note 16e)	4,143	2,567
Accrued royalties to the OCS (Note 14f)	1,170	-
Accrued expenses and other current liabilities	10,209	4,617
Total	\$ 30,830	\$ 22,853

d. Financial expenses, net:

Composition:

	Year ended December 31,		
	2011	2012	2013
Financial income	\$ 1,030	\$ 1,043	\$ 983
Financial costs related to long-term debt	(5,020)	(6,144)	(4,629)
Financial costs related to short-term credit and others	(1,599)	(1,828)	(3,577)
Gain (loss) from marketable securities, net (1) (2)	(911 )	257	987

Total \$(6,500) \$(6,672) \$(6,236)

(1) Includes gains (losses) from trading securities still held by the Company for the years 2011, 2012 and 2013 in amounts of \$ (197), \$ 957 and \$ 985, respectively (see Note 4).

(2) Includes impairment of available-for-sale marketable securities for 2011 and 2012 of \$ 714 and \$ 700, respectively (see Note 4).

e. Other expenses (income), net:

Composition:

	Year ended December 31,		
	2011	2012	2013
gain (loss) on sale of fixed assets, net	\$ (92 )	\$ (22 )	\$ 14
Other loss (income)	(115 )	(152 )	-
Total	\$ (207 )	\$ (174 )	\$ 14

F-67

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**Note 17: - Supplementary Financial Statement Information (Cont.)**

f. Operating segments:

The Company operates in the software services and proprietary software products and related services through its three directly held subsidiaries: Matrix, Magic and Sapiens, respectively.

**Matrix**

Matrix provides software solutions and services, software development projects, outsourcing, integration of software systems and services – all in accordance with its customers' specific needs. Matrix also provides upgrading and expansion of existing software systems. Matrix operates through its directly and indirectly held subsidiaries in the following segments: (1) Software solutions and services (Information Technology – IT); (2) Learning and integration; (3) Computer infrastructure and integration solutions; and, (4) Software product marketing and support.

*Software solutions and services:*

The software solutions and services provided by Matrix consist of providing tailored software solutions and upgrading and expanding existing software systems. These services include, among others, developing customized software, adapting software to the customer's specific needs, implementing software and modifying it based on the customer's needs and integrating all or part of the above elements. The scope of work invested in each element varies from one customer to the other.

*Learning and integration:*

Matrix's activities in this segment consist of operating a network of high-tech training and instruction centers which provide application courses, professional training courses and advanced professional studies in the high-tech industry.

*Computer infrastructure and integration solutions:*

Matrix's activities in this segment consist of: (1) providing computer and telecommunication infrastructure solutions; (2) selling and marketing personal computers, portable computers, Intel servers, peripheral equipment, operating systems, servers and workstations that use UNIX and VMS and selling and marketing mainframe storage and backup systems such as IP and IBM; (3) providing computer and peripheral equipment maintenance services, lab and helpdesk services.

*Software product marketing and support:*

Matrix's activities in this segment include marketing and support for various software products the principal of which being CRM, computer systems management infrastructures, web world content management, database and data warehouse mining, application integration, database and systems, data management and software development tools.

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**Note 17: - Supplementary Financial Statement Information (Cont.)**

**Magic**

Magic is a global provider of proprietary application development and business process integration software solutions and related professional services, and a vendor of IT outsourcing services.

Magic software solutions are used by customers to develop, deploy and integrate on-premise, mobile and cloud-based business applications quickly and cost effectively. In addition, its technology enables enterprises to accelerate the process of delivering business solutions that meet current and future needs and allow customers to dramatically improve their business performance and return on investment. Its software solutions include application platforms for developing and deploying specialized and high-end large-scale business applications (Magic xpa application platform, formerly branded uniPaaS and Appbuilder) and an integration platform that allows the integration and interoperability of diverse solutions, applications and systems in a quick and efficient manner (Magic xpi business and process integration platform, formerly branded iBOLT). These solutions enable Magic customers to improve their business performance and return on investment by supporting the affordable and rapid delivery and integration of business applications, systems and databases.

Using its products solutions, enterprises and independent software vendors can accelerate time-to-market by rapidly building integrated solutions, deploying them in multiple environments while leveraging existing IT resources. In addition, its solutions are scalable and platform-agnostic, enabling its customers to build solutions by specifying their business logic requirements in a commonly used language rather than in computer code, and to benefit from seamless platform upgrades and cross-platform functionality without the need to re-write applications. Magic technology also enables future proof protection and supports current market trends such as the development of mobile applications that can be deployed on a variety of smartphones and tablets, and cloud environments.

With respect to IT outsourcing services, Magic offers a complete portfolio of professional services in the areas of infrastructure design and delivery, application development, technology consulting planning and implementation

services, support services and supplemental staffing services.

Magic products and services are available through a global network of regional offices, independent software vendors, system integrators, distributors and value added resellers as well as original equipment manufacturers and consulting partners in approximately 50 countries.

F-69

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**Note 17: - Supplementary Financial Statement Information (Cont.)**

**Sapiens**

Sapiens is a leading global provider of proprietary software solutions for the insurance industry, with an emerging focus on the broader financial services sector. We offer core software solutions for Property & Casualty/General Insurance, or P&C, and Life, Annuities, & Pensions, or L&P, providers, allowing them to manage policy administration, claims management and billing functions. Sapiens also provides record-keeping software solutions for providers of Retirement Services and offer a variety of technology-based solutions that enable organizations to deploy business logic and comply with policies and regulations across their organizations. Sapiens solutions enable customers to respond to evolving market needs and regulatory changes, while improving the efficiency of their core operations, thereby increasing revenues and reducing costs.

Sapiens has developed scalable, configurable, rule-based core software platforms which offer its clients comprehensive and function-rich solutions. Sapiens solutions allow its customers to support new delivery channels such as mobile and social, rapidly deploy new products, and improve operational efficiency. As its software is customizable to match specific business requirements, it supports its customers' operations across different market segments, geographies and regulatory regimes. In addition, its software solutions enable compliance with complex and rapidly evolving regulations in the insurance and wider financial services industry.

Sapiens technology-based solutions include application development and business decision management platforms. Its application development platforms allow for the deployment of tailor-made solutions that address unique business needs for which pre-packaged software solutions may not be available. Its business decision management platform, Sapiens DECISION, allows business professionals to design, simulate, implement, change and analyze the business logic that drives financial operations and compliance in a business-friendly format and environment. Its platform facilitates the swift deployment of new or changed business logic that originates from regulatory updates or market changes, reduces costs and improves efficiency by shortening the software development lifecycle. This platform empowers the organization's business users as they manage their business strategy, rules and logic by using business terms rather than programming language. Sapiens' insurance solutions are deployed at leading insurance carriers globally. Sapiens' service offerings include a standard consulting offering that helps customers make better use of IT

in order to achieve their business objectives.

From August 21, 2011, the date on which Formula lost its control in Sapiens, as described in Note 1, until January 27, 2012, the date on which Formula regained its control in Sapiens, as described in Note 1, Sapiens' results of operations were reflected in the Company's results using the equity method of accounting and therefore were not considered an operating segment during this period.

F-70

**FORMULA SYSTEMS (1985) LTD.****AND ITS SUBSIDIARIES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data****Note 17: - Supplementary Financial Statement Information (Cont.)**

On November 19, 2013, the date on which Formula's interest in Sapiens' outstanding common shares diluted from 56.8% to 48.6% until December 31, 2013, as described in Note 1, Sapiens' results of operations were reflected in the Company's results using the equity method of accounting and therefore were not considered an operating segment during this period. .

The Company evaluates the performances of each of its directly held subsidiaries based on operating income/loss. Headquarters and finance expenses of Formula are allocated proportionally among the subsidiaries:

	Matrix	Sapiens	Magic	Total	
<b>Revenues:</b>					
2013	\$535,585	\$117,281	\$144,958	\$797,824	
2012	514,931	104,110	126,380	745,421	
2011	491,144	36,515	113,328	640,987	
<b>Inter-segment sales:</b>					
2013	870	-	280	1,150	
2012	690	-	-	690	
2011	370	-	-	370	
<b>Operating income:</b>					
2013	35,169	9,015	17,351	61,535	
2012	33,525	7,825	15,645	56,995	
2011	30,974	4,487	13,989	49,450	
<b>Identifiable assets:</b>					
2013		357,625	-	108,067	465,692

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2012	325,203	99,598	104,204	529,005
Goodwill:				
2013	165,253	-	62,181	227,434
2012	155,628	119,701	51,531	326,860
Identifiable liabilities:				
2013	226,127	-	23,762	249,889
2012	189,080	46,580	23,859	259,519
Depreciation and amortization:				
2013	7,381	8,588	8,380	24,349
2012	7,873	10,333	7,444	25,650
2011	5,893	3,430	5,040	14,363
Investments in segment assets:				
2013	3,577	2,794	497	6,868
2012	3,157	1,327	510	4,994
2011	8,048	362	497	8,907

F-71

**FORMULA SYSTEMS (1985) LTD.****AND ITS SUBSIDIARIES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data****Note 17: - Supplementary Financial Statement Information (Cont.)**

The following table presents reconciliation, between the data concerning revenues, assets and liabilities appearing in the individual operating segments' financial statements and the corresponding data appearing in the Company's consolidated financial statements:

	Year ended December 31,		
	2011	2012	2013
Revenues:			
Revenues as above	\$640,987	\$745,421	\$797,824
Less inter-segment transactions	(370 )	(690 )	(1,150 )
Revenues as per statements of operations	\$640,617	\$744,731	\$796,674

	December 31,	
	2012	2013
Identifiable assets:		
Total assets of operating segments	\$855,865	\$693,126
Assets not identifiable to a particular segment	26,067	184,352
Elimination of inter-segment assets and other	(296 )	-
Total assets as per consolidated balance sheets	881,636	877,478
Identifiable liabilities:		
Total liabilities of operating segments	259,519	249,889
Liabilities not identifiable to a particular segment	153,751	145,751
Elimination of inter-segment liabilities and other	(296 )	-
Total liabilities as per consolidated balance sheets	\$412,974	\$395,640

g.

Geographical information:

1. The Company's long-lived assets are located as follows:

	December 31,	
	2012	2013
Israel	\$19,328	\$18,018
United States	619	439
Europe	1,140	682
Japan	290	209
Other	82	60
Total	\$21,459	\$19,408

F-72

**FORMULA SYSTEMS (1985) LTD.****AND ITS SUBSIDIARIES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share and per share data****Note 17: - Supplementary Financial Statement Information (Cont.)**

## 2. Revenues:

The Company's revenues classified by geographic area (based on the location of customers) are as follows:

	Year ended December 31,		
	2011	2012	2013
Israel	\$486,025	\$500,775	\$526,972
International:			
United States	92,484	137,298	155,002
Europe	38,377	74,126	84,864
Other	23,731	32,532	29,836
Total	\$640,617	\$744,731	\$796,674

## h. Earnings per share:

The following table presents the computation of basic and diluted net earnings per share for the Company:

	Year ended December 31,		
	2011	2012	2013
Numerator:			
Net income basic earnings per share - income available to shareholders	\$42,962	\$24,030	\$80,985
Amount for diluted earnings per share - income available to shareholders	42,962	24,030	80,985

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Weighted average shares outstanding			
Denominator for basic net earnings per share	13,514	13,596	13,725
Effect of dilutive securities	155	194	398
Denominator for diluted net earnings per share	13,669	13,790	14,123
Basic net earnings per share	3.17	1.78	5.90
Diluted net earnings per share	\$3.11	\$1.72	\$5.70

F-73

**FORMULA SYSTEMS (1985) LTD.**

**AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**NOTE 18:- SUBSEQUENT EVENT**

On January 2014 Formula finalized the terms of a NIS 200,000 loan (approximately \$57,620) extended to it by an Israeli institutional investor. The loan is secured by certain of the shares of each of Formula's publicly held subsidiary and affiliated companies Matrix, Magic and Sapiens. The loan's average duration is approximately four years (paid over a period of 6 years) and carries fixed annual interest rate of 5.5%. Formula intends to use the loan proceeds to promote new investments as well as for the continued investment in its foregoing three subsidiaries, all in accordance with its growth and business development strategies.

On March 5, 2014, Magic completed a follow-on public of its ordinary shares on the NASDAQ. Magic issued 6,900,000 ordinary shares, including 900,000 shares sold pursuant to the underwriters' full exercise of their over-allotment option at a price to the public of \$8.50 per share. Magic's net proceeds from the offering are expected to amount to approximately \$54.7 million after deducting underwriting discounts and commissions. As a result of Magic's issuance of its ordinary shares, Formula percentage interest in Magic decreased from 51.6% to 45.0%.

On April 4, 2014 the Company acquired the operations of, a US-based full-service provider of consulting and staffing solutions for IT, Engineering and other professional staff (i.e. accounting and finance, administrative, customer service, healthcare (Nursing, Clinical, Lab, Scientific), human resources, manufacturing, marketing/sales, and Operations) for a total consideration of \$4,000. The company believes the acquisition will broadens its existing U.S. footprint and adds leading Fortune 500 companies to its customer base, making an important contribution to its growth strategy.

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F-75

F-76

F-77

F-78