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

[X] 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:

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

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 x

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 x

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 x 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 x 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 o Accelerated filer x Non-accelerated filer o

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

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

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 o Item 18 o

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 S

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:

ITEM 19. EXHIBITS

Exhibit No.	
1.1	Memorandum of Association [1]
1.2	Amended and Restated Articles of Association, as adopted by Formula Systems (1985) Ltd. on January 8, 2012 [2]
2.1	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. [1]
4.1	Form of Letter of Indemnification for officers and directors, adopted by Formula Systems (1985) Ltd. on January 8, 2012 [3]
4.2	English translation of Formula Systems (1985) Ltd. Employees and Office Holders Share Option Plan (2008)[4]
4.3	Formula Systems (1985) Ltd. 2011 Share Incentive Plan and amendment +
8	List of Subsidiaries+
12.1	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a)/Rule 15d-14(a) under the Exchange Act*
12.2	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a)/Rule 15d-14(a) under the Exchange Act*
13.1	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*
13.2	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*
15.1	Consent of Kost, Forer, Gabbay & Kaiserer, a member of Ernst & Young Global*
15.2	Consent of Levy Cohen and Co.*
15.3	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

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCUNTING 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

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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.

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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

FORMULA SYSTEMS (1985) LTD.

AND ITS SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

	December 31, 2012	December 31, 2013
ASSETS		
CURRENT ASSETS:		
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
Total current assets	369,002	338,911
LONG-TERM RECEIVABLES:		
Marketable Securities (Note 4)	331	520
Deferred taxes (Note 16e)	13,618	13,152
Prepaid expenses and other accounts receivable	5,285	8,761
Total 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
Total assets	$881,636	$877,478

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

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FORMULA SYSTEMS (1985) LTD.

AND ITS SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands (except share and per share data)

	December 31, 2012	December 31, 2013
LIABILITIES AND EQUITY		
CURRENT LIABILITIES:		
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
Total current liabilities	224,010	210,970
LONG-TERM LIABILITIES:		
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
Total long-term liabilities	166,847	161,141
COMMITMENTS AND CONTINGENCIES (Note 14)		
REDEEMABLE NON-CONTROLLING INTEREST (Note 2d)	22,117	23,529

EQUITY (Note 15):
Formula Systems (1985) equity:
Share capital:
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.

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
Total equity	468,662	481,838
Total liabilities, redeemable non-controlling interest and equity	$881,636	$877,478

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

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
Diluted	$3.11	$1.72	$5.70
Shares used in computing earnings per share (Note 17h):			
Basic	13,513,500	13,596,000	13,724,652
Diluted	13,669,297	13,789,766	14,122,779

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	Amount	**Additional** paid-in capital	Retained earnings	**Accumulated other** comprehensive income (loss)	Treasury shares (cost)	**Non-** controlling interests	**Total** Equity
Balance as of January 1, 2011	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)

Balance as of December 31, 2011	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 expenses (Note 12a)	-	-	1,988	-	-	-	2,932	4,920
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.

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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 Capital		Additional paid-in	Retained	Accumulated other comprehensive	Treasury shares	Non-controlling	Total
	Number	Amount	capital	earnings	**income** (loss)	(cost)	interests	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.

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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.

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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

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.

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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)	-

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.

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.

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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

a. 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 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).

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.

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

	Percentage of ownership and control December 31,	
Name of subsidiary (affiliate)	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.

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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 estimate**s

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.

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.

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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.

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 then 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.

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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.

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

l. **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.

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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.

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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.

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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.

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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.

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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.

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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.

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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).

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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.

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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):

	Year ended December 31,		
	2011	**2012**	**2013**
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.

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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.

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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 hed