

NOTES TO THE FINANCIAL STATEMENTS FOR 2011



1. Accounting policies

a. General

The financial statements are presented in accordance with generally accepted accounting principles (Israeli GAAP), adapted for the special activity of a central bank and consistent with the practice of other central banks.

The main items presented in accordance with generally accepted accounting principles of central banks are:

1. Revaluation accounts—as detailed in Section 1.m below.
2. Cash-flow statements—as detailed in Section 1.t below.

b. Definitions

In these financial statements:

1. **"The Bank"**—the Bank of Israel.
2. **"CPI"**—the Consumer Price Index as published by the Central Bureau of Statistics.
3. **"Adjusted amount"**—the nominal historical amount adjusted to the CPI in respect of December 2003, in accordance with the provisions of Opinions 23 and 36 of the Institute of Certified Public Accountants in Israel.
4. **"Reported amount"**—the adjusted amount at the transition date (December 31, 2003), with additional amounts in nominal values that were added after the transition date, less amounts subtracted after the transition date.
5. **"Nominal financial reporting"**—financial reporting based on reported amounts.
6. **"Fair value"**—the amount for which it was possible to acquire or sell an asset (to undertake or repay a liability) in a current transaction between parties acting voluntarily.

c. Financial statements in reported amounts

1. In October 2001, the Israel Accounting Standards Board published Accounting Standard No. 12, "Discontinuance of Adjustment of Financial Statements". Pursuant to this standard, and in accordance with Accounting Standard No. 17, which was published in December 2002, the adjustment of financial statements for the effect of inflation was discontinued as of January 1, 2004.



2. In the past, the Bank prepared its financial statements on the basis of historical cost, with no adjustment for changes in purchasing power of the Israeli currency. In the financial statements for 2005, comparative figures for the year ended December 31, 2003, were recalculated on a historical-cost basis, adjusted for changes in the CPI as required by Accounting Standard No. 12, in order to prepare for the transition to nominal financial reporting.

The adjusted amounts at December 31, 2003 constituted the starting point for the nominal financial report as of January 1, 2004. Any additions and disposals made during the period were included in their nominal values.

3. Amounts of non-monetary assets do not necessarily reflect their realizable value or current economic value, but only the reported amounts of those assets.
4. The term "cost" in these financial statements, denotes the reported amount of cost.

d. Reporting principles

1. Balance Sheet:
 - a. Non-monetary items (mainly fixed assets and investments shown at cost) are stated in reported amounts.
 - b. Monetary items are stated in the balance sheet at their nominal values at the balance sheet date.
 - c. The balance sheet is presented in the format generally accepted by central banks worldwide.
2. Statement of Operations:
 - a. Income and expenses originating in non-monetary items (e.g., depreciation, prepaid expenses, and deferred income) or from provisions included in the balance sheet, are derived from the difference between the reported amount of the opening balance and the reported amount of the closing balance.
 - b. All other operating items (such as interest income and expense) are stated at their nominal values.

3. Statement of changes in equity:

The new Bank of Israel law came into effect on June 1, 2010 and on that date the Bank of Israel Law, 5714-1954 was repealed.

In accordance with Section 76 of Bank of Israel Law, 5770-2010, within three months from the end of each year the Bank will transfer its profits to the government according to the following provisions:

- a. If the equity amounts to 2.5 percent or more of total assets, the government will receive an amount equal to the net profit, less any deficit in retained earnings.

- b. If the equity amounts to more than 1 percent of total assets but less than 2.5 percent of total assets, the government will receive 50 percent of the net profit, less any deficit in retained earnings.
- c. If the equity amounts to 1 percent or less of total assets, the government will not receive any profits.

The Bank is permitted to record capital reserves arising from accounting principles, providing that the balance of net profit not transferred to the government as aforementioned is added to the retained earnings and not recognized as another capital item, unless agreed otherwise between the Governor and the Minister of Finance.

In accordance with these provisions, as of December 31, 2011 there is no obligation to transfer funds to the government.

e. Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires the Bank's management to make estimates and assumptions regarding transactions or matters the final effect of which, on the financial statements, cannot be determined with precision at the time the statements are prepared. Even though the estimates and assumptions are based on management's best judgment, the final effect of such transactions or matters may be different from the estimates and assumptions made in their respect.

f. Income recognition

Income and expenditure are charged to the Statement of Operations on an accrual basis.

Realized profits or losses from foreign currency and securities in local and foreign currency are transferred to the Statement of Operations. These profits or losses are calculated on the basis of average cost of the balances in that asset.

Unrealized profits are not transferred to the Statement of Operations, instead they are charged to the "Revaluation accounts" line in the balance sheet.

Unrealized losses are transferred to the Statement of Operations after offsetting unrealized profits in the same asset. These losses derive from the difference between the average cost of an asset and its fair value.

Unrealized losses from foreign currency securities, from local currency securities, or a specific foreign currency are not offset against unrealized profits from other securities or foreign currency.

Losses recognized in the Statement of Operations are not offset against unrealized profits that will accrued in the future.



g. Securities

Foreign currency securities

Tradable foreign currency securities are stated in the balance sheet at their fair value at the balance sheet date. The fair value of quoted securities is based on market prices. Unquoted securities are revalued on the basis of data obtained from outside sources.

The adjusted cost of securities is their face value plus the interest, indexation differentials and the balance of the premium or discount not yet amortized. The premium or discount is amortized over the period from the date of purchase until the date of redemption.

The difference between the original cost of the securities and their face value plus interest and the balance of the premium or discount not yet amortized is charged to the Statement of Operations.

Differentials from linkage to an index published overseas that accumulated on the principal and were not yet realized, as well as the difference between the fair value of the securities and their adjusted cost, are charged to the "Revaluation accounts" line in the balance sheet.

Interest income and amortization of the premium or discount are charged to the Statement of Operations on an accrual basis, and are stated in the item "Interest income from assets in foreign currency abroad".

Income from the disposal of securities is stated under "Other financial income (expenses on)—securities and derivative financial instruments".

The balance of the unrealized losses is charged to the Statement of Operations at the end of the year and stated under "Other financial income from (expenses on)—securities and derivative financial instruments".

Local currency securities

Tradable local currency government securities are stated in the balance sheet at their fair value at the balance sheet date.

The difference between the original cost of securities and their face value, plus interest and the balance of the premium or discount not yet amortized, is charged to the Statement of Operations.

CPI-indexation differentials accumulated on the principal and as yet unrealized, as well as the difference between the fair value of the securities and their adjusted cost, are charged to the "Revaluation accounts" line in the balance sheet.

Interest income from local-currency securities and amortization of the premium or discount are charged to the Statement of Operations on an accrual basis, and stated under "Interest income from the government".

The balance of unrealized losses is charged to the Statement of Operations at the end of the year and stated under "Other financial income from (expenses on)—securities and derivative financial instruments".

h. International financial institutions

International Monetary Fund (IMF)

The Bank of Israel's participation in the IMF less its liabilities on account of this participation is shown on the Assets side in the "International Monetary Fund" item.

The loans that were granted to the IMF according to the NAB arrangement and the Bank's Special Drawing Rights Holdings (SDR Holdings) are shown on the Assets side of the balance sheet under the item "International Monetary Fund". (See Note 3.)

Liabilities in respect of Drawing Rights granted by the IMF are shown on the liabilities side in the "International financial institutions" item.

Balances related to other international financial institutions and investment in shares of the Bank for International Settlements (BIS)

The Bank of Israel's participation in other international financial institutions includes initial participation in their capital and additional participation payments toward increases in these institutions' capital. The Bank of Israel's participation in other international financial institutions is shown on the Assets side in the "International financial institutions" item according to the cost in the currency in which the participation was paid, expressed at the exchange rate on the transaction date. Liabilities to international financial institutions are shown on the Liabilities side in the "International financial institutions" item.

i. Fixed assets

1. Fixed assets are stated at cost less accumulated depreciation. Cost includes expenses directly attributable to the purchase of the asset.
2. Improvements and enhancements are charged to the cost of the assets, whereas maintenance and repairs expenses are charged to the Statement of Operations as incurred.
3. Depreciation is calculated by the straight-line method on the basis of the estimated useful life of the asset:
 - Buildings—fifty to sixty-seven years;
 - Motor vehicles—six and a half years;
 - Computers—four years;
 - Equipment—ten years.
4. Software that is not an integral part of the related hardware is shown under fixed assets at cost and depreciated by the straight-line method over four years.



- Purchases of fixed assets in insignificant amounts are charged to the Statement of Operations.

j. Banknotes and coins in circulation

Banknotes and coins in circulation that were issued by the Bank reflect a liability on the Bank's part to their holders. This liability is shown in the Bank's balance at face value.

k. Short-term loan

The balance of short-term loan (called *makam*, their Hebrew acronym) in the balance sheet reflects the redemption price of *makam* held by the public, less the balance of unamortized discount. *Makam* sold by the government to the Bank of Israel but not yet sold to the public are not included in this balance.

Makam are issued for a period of up to a year. The discount is the difference between the redemption price of the *makam* and the proceeds of their sale to the public.

The discount is amortized over the period from its date of issuance to its date of redemption.

Expenses for amortization of the discount on the balance of *makam* held by the public are shown in the Statement of Operations in the "Interest expense to banks and the public" item.

l. Liabilities on account of employees' entitlements

All liabilities on account of employer-employee relations have corresponding reserves in accordance with law, agreement, practice and management's expectations.

Liabilities on account of employee pensions and severance pay are calculated by an expert actuary using the method of estimation of cumulative benefits with probabilities taken into account on the basis of past experience. The discount rate applying to the reserves is set in accordance with the rate established in directives issued by the Supervisor of Banks, and the rate of future salary increases is estimated by the management.

The provision for vacation pay is computed on the basis of the accrued vacation days at October 31, 2011 and the effective salary for vacation redemption at the balance sheet date. The difference in the liability that derives from the accrual of vacation days between October 31, 2011 and December 31, 2011 is immaterial. (see Note 14.)



m. Revaluation accounts

The revaluation accounts include unrealized profits from exchange rate differentials on balances denominated in foreign currency and unrealized profits from indexation and the revaluation of tradable securities in local currency and foreign currency to their fair value.

Separate revaluation accounts are maintained for each item (currency, security) and are transferred to the Statement of Operations when the item is fully or partially realized. No offsetting among different types of items is performed.

Any net loss in the revaluation accounts that originates in indexation differentials and price differentials in local currency and foreign currency securities and exchange rate differentials on foreign currency balances is transferred to the Statement of Operations at the end of the year. (See also Section f above).

n. Foreign currency

Assets and liabilities denominated in or indexed to foreign currency are shown in New Israel Shekel (NIS) according to the representative rates of exchange published by the Bank of Israel at the balance sheet date.

Income and expenses in foreign currency are included in the Statement of Operations at the representative rates of exchange in effect on the value day of the performance of each transaction.

Exchange rate differentials arising from the adjustment of assets and liabilities due to changes in the exchange rate include realized and unrealized exchange rate differentials.

Unrealized exchange rate differentials are charged separately for each currency to the "Revaluation accounts" item. Realized exchange rate differentials are transferred to the Statement of Operations and are calculated on the basis of the average cost of the balances of the currency at issue. Realization is calculated separately for foreign currency assets and foreign currency liabilities in each calendar month and for each currency.

The loss balance in the revaluation accounts at the end of the year is transferred to the Statement of Operations and is not offset against future unrealized profits.

Unrealized losses in one currency are not offset against unrealized profits in another currency.



The following table details NIS exchange rates against other key currencies:

	December 31			Change	
	2011	2010	2009	2011	2010
	(NIS)			(Percent)	
USD	3.8210	3.5490	3.7750	7.7	(6.0)
Euro	4.9381	4.7379	5.4417	4.2	(12.9)
Pound sterling	5.8918	5.4928	6.1112	7.3	(10.1)
Special drawing rights (SDR) ^a	5.8662	5.4825	5.9180	7.0	(7.4)

^a The SDR rate is published by the IMF, and is based on a weighted 4-currency basket consisting of USD, €, ¥ and £.

o. Indexation

Assets and liabilities linked to the CPI are shown in accordance with the indexation conditions determined for each balance.

Following are details of the CPI (based on the 2002 average):

		December 31			Change	
		2011	2010	2009	2011	2010
		(Points)			(Percent)	
CPI	November	120.4	117.4	114.8	2.6	2.3
	December	120.4	117.8	114.8	2.2	2.6

p. Interest rates

Some of the local currency interest on the government's and the banks' balances, which are collected or paid by the Bank of Israel, are based on the Bank of Israel interest rate or the prime interest rate.

The following are the interest rates as at December 31:

	December 31			Change	
	2011	2010	2009	2011	2010
	(Percent)				
Bank of Israel interest rate	2.75	2.00	1.25	37.5	60.0
Prime	4.25	3.50	2.50	21.4	40.0

q. Financial instruments

The Bank of Israel uses derivatives in its monetary policy and foreign exchange activities, both in Israel and abroad.

Activity in financial instruments in Israel

Forward NIS/USD conversion transactions

These transactions are shown net in the balance sheet under "Other assets" or "Other liabilities": future receipt of US dollars less future remittance of NIS.

In the Statement of Operations, the results of the transactions are shown under "Interest income from assets in foreign currency abroad".

Activity in financial instruments abroad

1. Repurchase (Repo) Agreements and Reverse-Repurchase (R.Repo) Agreements

The Bank carries out repurchase (Repo) agreements. Such a transaction is composed of the sale of securities under an agreement to purchase them in the future. The transaction is treated as a secured debt and accordingly the securities sold under its terms are not subtracted from the Bank's assets. The liability to purchase the securities is included in the "Repurchase agreements" item. In the Statement of Operations, the results of these transactions are shown in the "Interest expense on liabilities in foreign currency abroad" item.

The Bank also carries out reverse repo (R. Repo) agreements. These transactions are treated as a secured debt, and are included in the "Reverse repurchase agreements" item. Securities purchased within the framework of these agreements do not appear in the balance sheet. In the Statement of Operations, the results of these transactions are shown in the "Interest income from assets in foreign currency abroad" item.

2. Foreign currency swaps and forwards

These transactions are included in the balance sheet in the sum of the differences between the foreign currency received and the foreign currency to be remitted in the future, and are shown in net form in the "Derivative financial instruments" item.

In the Statement of Operations the results of these transactions are included in the "Interest income from assets in foreign currency abroad" item.



3. Futures

The balance of futures contracts at face value on the date of the financial statements is shown in Note 18—"Contingent liabilities and commitments".

In the Statement of Operations, the change in the value of the contracts is recorded under "Other financial income from (expenses on) securities and derivative financial instruments".

r. Offsetting financial balances

Financial assets and liabilities are presented in the balance sheet in net amount only when the Bank has a legal and enforceable offsetting right, and when it is intended to settle the asset or liability on a net basis or to realize the asset and settle the liability simultaneously.

s. Impairment of assets

The Bank applies Accounting Standard No. 15 (Amended)—Impairment of Assets (hereinafter: the Standard), which establishes procedures that the Bank must apply to ensure that its assets in the balance sheet (to which the Standard applies) are not stated in an amount greater than the recoverable amount, i.e., the net sale price or value in use (the present value of the estimated future cash flows expected to derive from the use and realization of the asset), whichever is higher.

The Standard applies to all balance sheet assets, except for financial assets. The Standard also lays down presentation and disclosure rules for assets that have been impaired. Where the value of an asset in the balance sheet exceeds its recoverable amount, the Bank recognizes an impairment loss in the amount of the difference between the asset's book value and its recoverable amount. A loss recognized in this manner is annulled only if changes occur in the estimates that were used to determine the recoverable amount of the asset from the date on which the last loss from impairment was recognized.

t. Cash-flow statements

These financial statements do not include cash-flow statements because such statements provide no significant information beyond that appearing in the financial statements; this practice corresponds with the general practice among central banks world wide.

u. Taxes

According to the Bank of Israel Law, 5770-2010, regarding the payment of taxes, municipal taxes, levies and other mandatory payments, the Bank is synonymous with the State of Israel, and therefore exempt from paying certain taxes such as income tax and capital gains tax.

2. Foreign currency assets and liabilities abroad

Foreign exchange reserves

As presented in the explanatory remarks, the economic analysis refers to foreign exchange reserves which consist of the balance of the "Foreign currency assets abroad" item less the balance in the "Foreign currency liabilities abroad" item. The Bank's investment policy relates to these balances.

Following is the composition of the foreign exchange reserves:

	December 31		December 31	
	2011	2010	2011	2010
	(NIS million)		(USD million)	
Foreign currency assets abroad	286,981	252,553	75,106	71,161
Less Foreign currency liabilities abroad	(884)	(882)	(231)	(248)
Total foreign exchange reserves	286,097	251,671	74,875	70,913

3. International Monetary Fund (IMF)

	December 31		December 31	
	2011	2010	2011	2010
	(NIS million)		(SDR million)	
IMF quota	6,225	5,089	1,061	928
Less liability for the quota	(4,315)	(3,953)	(735)	(721)
Reserve tranche^a	1,910	1,136	326	207
NAB loan	202	-	34	-
Special Drawing Rights (SDRs)	4,852	4,714	827	860
Total balance with IMF	6,964	5,850	1,187	1,067

^a The surplus of the reserve tranche over the basic sum of SDR 33 million bears interest at a rate set by the IMF from time to time. The annual rate of interest on December 31, 2011 was 0.11 percent (on December 31, 2010, 0.31 percent).

a. Bank of Israel participation in the IMF

Each member country of the International Monetary Fund has a quota for its participation in the Fund's capital which is denominated in the SDR currency. The quota is determined according to the country's economic indicators (national income, exports, balance of payments, and level of reserves) and it also determines the country's voting rights. The



part of the quota that is paid in cash (the Reserve tranche) is transferred to the Fund in foreign currency and may be withdrawn by the country, whereas the rest is deposited with the country's central bank in deposits and notes indexed to SDR.

In 2011 a reform was executed in the quotas and in the IMF's voting rights. In the first stage, which came into effect in March 2011, Israel's quota was increased by about SDR 133 million. At the end of the process the quota is expected to reach SDR 1,921 million.

Since 1999, Israel has been part of IMF's Financial Transaction Plan. This plan is a mechanism through which an IMF member country may exchange SDR or foreign currency against its local currency, and another country is asked to perform a counter exchange. These exchanges can affect the composition of the quota (between the Reserve tranche and the notes and deposits), and liabilities on account of the quota, but they do not affect the level of the quota.

In 2010 Israel joined the IMF's arrangement known as NAB (New Arrangements to Borrow), the aim of which is to increase, when necessary, the IMF's resources for assistance. This is an arrangement by which countries provide a credit line to the IMF, thus expressing readiness to lend to the IMF at times of need, so that it can provide credit to countries experiencing a crisis.

In accordance with this arrangement, Bank of Israel provides a credit line in the amount of SDR 500 million that can be used by the IMF at times of need. In the event of any action being taken in the framework of this arrangement, the funds will be transferred from the foreign exchange reserves of Israel. The IMF will pay the SDR interest on this loan, which is for five years. On November 17, 2011 the IMF decided that the repayment period of new loans provided as from November 17, 2012 would be ten years. It was also decided that the repayment period of loans that had been provided between the beginning of 2011 and November 16, 2012 would be extended retroactively from five to ten years. The loan may be returned to Israel at an earlier date at its request, if it should need these funds. There was activity in this framework in 2011: the Bank of Israel transferred funds at the request of the IMF.

b. Special Drawing Rights (SDRs)

The balance includes SDRs allocated by the IMF to Israel. Against these allocations the Bank has a liability towards the IMF with no repayment date, which is shown in the liabilities side under the "International financial institutions" item.

Following the economic crisis, in 2009 the IMF decided to allocate to its members SDRs in the amount of USD 250 billion to support their foreign currency balances. In this context, in August and September 2009, the IMF made two SDR allocations, in which SDR 777 million was provided to Israel. In all, the IMF has granted Israel SDR 884 million to date. (See Note 12.)

At the end of 2009, Israel joined another IMF plan, "Voluntary arrangement for the purchase and sale of SDRs". Within the framework of this plan, Israel may be asked to sell or buy some SDRs from other IMF members, as instructed by the Fund. The total amount of these transactions may range from 50 percent to 145 percent of the accumulated allocation balance of the SDRs granted to Israel to date. The purchase or sale of SDRs according to this plan affect the balance of the SDRs held by the Bank of Israel, but not the balance of the Reserve tranche.

4. Credit to the government

a. Binational funds

Credit on account of binational funds was given to the government of Israel for investment in conjunction with the United States government in binational funds involved for research, industrial development, and science. The funds deposited these amounts with the Bank of Israel and they are shown in the balance sheet as liabilities under the "Other liabilities" item. Part of the funds' credit and deposits earn fixed interest of 4 percent to 4.125 percent and the other part earns interest on the basis of LIBOR.

b. Long-term advances

The balance of long-term advances was zero as at December 31, 2011 and December 31, 2010.

In March 2010, an agreement was signed with the government regarding the restructuring of the debt with an option for early repayment, thus ending the disagreements between the Bank and the government regarding these amounts.

In accordance with the agreement, the debt was calculated for purposes of the restructuring, and Bank of Israel agreed to lower the interest rate and extend the repayment period. In addition, in accordance with the new conditions, the government was granted an early repayment option at amounts discounted to the date of payment. The government took advantage of the option and repaid the debt of NIS 394 million early, on March 9, 2010. The difference between the balance of the debt before signing the agreement and the amount of the early repayment was recognized in the Statement of Operations in previous years. (See Note 20.)

5. Tradable local currency securities

This item consists of tradable government securities indexed to the last CPI known on the balance sheet date, as well as unindexed securities. The securities are shown at fair value.

The yield to maturity on the securities portfolio at December 31, 2011 is 2.58 percent (December 31, 2010—2.85 percent).



6. Other assets

	December 31	
	2011	2010
	(NIS millions)	
Loans to employees	139	162
Sundry receivables	2	6
Total other assets	141	168

7. International financial institutions

	December 31	
	2011	2010
	(NIS million)	
Investment in BIS shares	282	282
Balance related to other international financial institutions ^{a,b}	641	644
Total	923	926

^a As follows:

- i) The World Bank Group
 - 1. IBRD—The International Bank for Reconstruction and Development
 - 2. IDA—The International Development Agency
 - 3. MIGA—The Multilateral Investment Guarantee Agency
 - 4. IFC—The International Finance Corporation
- ii) EBRD—The European Bank for reconstruction and Development
- iii) IDB—The Inter-American Development Bank
 - IIC—The Inter-American Investment Corporation

^b The methods for measuring and estimating the cost of investments and the investment estimates in reported values were changed in 2011 and 2010. The effect of the change amounted to an expense of NIS 3 million in 2011 and to income of NIS 90 million in 2010.

In 2011 Israel made a commitment to the ninth general capital increase of the Inter-American Development Bank (IDB). In this framework, the Bank of Israel undertook to purchase 223 paid-in shares and 8,966 callable shares for amounts of USD 2 million and USD 108 million, respectively.

The proceedings required in IDB were not completed in 2011 and therefore the liabilities are included in the contingent liabilities note. (See Note 18.)

8. Fixed assets^a

	Land and buildings ^b	Equipment, furniture, computers, software, and vehicles	Total
	(NIS million)		
Cost			
Balance as of December 31, 2010	229	196	425
Additions	7	39	46
Disposals	-	(1)	(1)
Balance as of December 31, 2011	236	234	470
Accumulated depreciation			
Balance as of December 31, 2010	45	102	147
Additions	5	23	28
Disposals	-	(1)	(1)
Balance as of December 31, 2011	50	124	174
Net book balance as of December 31, 2011	186	110	296
Net book balance as of December 31, 2010	184	94	278

^a A numismatic collection is kept at the Bank of Israel, which includes banknotes and coins issued in Israel from ancient times until today, along with various other items. According to an expert appraisal in November 2005, the value of the ancient coin collection is USD 1.7 million (the rest of the collection has yet to be appraised). The "Fixed assets" item does not include this collection.

^b The land of the Bank's premises in Jerusalem, with a depreciated cost of structures thereon amounting to NIS 173 million as of December 31, 2011 (NIS 174 million as of December 31, 2010), is leased from the Israel Land Administration through June 30, 2016. The Bank holds an option to extend the lease for another 49 years.

9. Banknotes and coins in circulation

	December 31, 2011		December 31, 2010	
	Quantity	NIS	Quantity	NIS
	(million)		(million)	
Banknotes in circulation				
NIS 20	34	683	35	709
NIS 50	46	2,288	48	2,397
NIS 100	141	14,090	145	14,486
NIS 200	152	30,356	129	25,773
Coins in circulation		1,556		1,461
Other ^a		2		2
Total		48,975		44,828

^a Consisting mainly of old banknotes that can be exchanged in the Bank of Israel.





On December 31, 2010 the legal date passed for exchanging Series A NIS banknotes and coins of a value of 5 agorot. On the same day the Bank recognized income in the amount of the face value of the Series A NIS banknotes and coins of a value of 5 agorot that are held by the public and were not exchanged in an amount of NIS 220 million. (See Note 28.)

10. Government deposits

Government balances comprise balances in local currency and balances in foreign currency.

All the government local currency balances in the Bank of Israel (excluding several extraordinary balances) can be offset against each other. The parties have no intention of offsetting the government's local currency balances with its foreign currency balances, and these balances are therefore stated separately.

	December 31		December 31	
	2011	2010	2011	2010
	(NIS million)		(USD million)	
Foreign currency^a				
Current deposits	959	307	251	87
Other foreign currency deposit	1,049	921	275	259
Total foreign currency deposits	2,008	1,228	526	346
Local currency^b				
Current deposits	10,568	12,979		
Total government deposits	12,576	14,207		

^a **Government foreign currency deposits**

The current deposits are used for financing budgetary activity. Some foreign currency government deposits bear interest at the rate paid on US Treasury bills with an average of six months to maturity. The rate of interest on December 31, 2011 was 0.061 percent (on December 31, 2010, 0.19 percent).

^b **Government local currency deposits**

The current deposits and the balances used for bond lending are designated for financing budgetary activity. Local currency current deposits, other than the government balances used for bond lending, bear (when in debit) or are paid (when in credit) interest at the prime rate. The average prime rate in 2011 was 4.38 percent (in 2010, 3.1 percent).

Government balances used for bond lending are paid interest at the Bank of Israel interest rate. The average interest rate on such balances in 2011 was 2.88 percent (in 2010, 1.6 percent).

11. Deposits of banking corporations

	December 31		December 31	
	2011	2010	2011	2010
	(NIS million)		(USD million)	
Foreign currency deposits^a				
Demand deposits	2,410	1,541	631	434
Local currency deposits^b				
Time deposits	106,024	78,374		
Demand deposits	23,414	21,483		
Total local currency deposits	129,438	99,857		
Total deposits of banking corporations	131,848	101,398		

^a Foreign currency deposits

Foreign currency demand deposits (called Pamach) serve as a liquid asset against nonresidents' foreign currency deposits. The reserve requirement ranges from 0 percent to 6 percent, depending on the term of the deposit.

^b Local currency deposits

1. The Bank of Israel receives local currency time deposits from the banks. The deposits are allocated by auction for terms of one day or one week. The deposits are not considered liquid assets with regard to the banking corporations' reserve requirements. In addition, deposits are received at the (overnight) deposit window available to the banking corporations at an interest rate of 0.5 percentage points under the Bank of Israel interest rate (until November 24, 2010 it was 0.25 percentage points under the Bank of Israel interest rate).

The interest rate for deposits at the window on December 31, 2011 was 2.25 percent (on December 31, 2010, 1.5 percent).

The average interest rate for deposits at the window in 2011 was 2.54 percent (in 2010, 1.4 percent).

The average interest rate for time deposits by auction on December 31, 2011 was 2.75 percent (on December 31, 2010, 1.99 percent).

The average interest rate for time deposits by auction in 2011 was 2.93 percent (in 2010, 1.59 percent).

2. The banking corporations' local currency demand deposits serve as a liquid asset against residents' local currency deposits. The reserve requirements ranges from 0 percent to 6 percent, depending on the term of the deposit.

12. International financial institutions

	December 31		December 31	
	2011	2010	2011	2010
	(NIS million)		(SDR million)	
Special Drawing Rights allocated ^a	5,184	4,846	884	884
Liabilities to international financial institutions ^b	6	44	1	8
Total	5,190	4,890	885	892

^a Special Drawing Rights (SDRs) are sums that member states in the International Monetary Fund (IMF) undertook to purchase from the Fund. No repayment date has been set for this liability. The IMF allocates SDR to its constituent states commensurate with the size of their quotas. In 2009 the IMF made two allocations to Israel, totaling SDR 777 million. (see Note 3.) Israel's allocation so far is SDR 884 million.

^b Liabilities in notes, deposits or letters of guarantee to the following institutions: IDA, IBRD, EBRD, MIGA and IDB. (see Note 1.h.)





13. *Makam*

	December 31	
	2011	2010
	(NIS million)	
Redemption value of <i>makam</i> sold to the public	123,418	136,418
Less discount at time of sale to public	(3,579)	(2,975)
Proceeds of sale of <i>makam</i> to the public	119,839	133,443
Plus reduction in discount for period to balance sheet date	1,693	1,466
Total balance of <i>makam</i>	121,532	134,909

The Short-Term Loan Law, 5744-1984, authorizes the government to issue short-term bills (called *makam*, their Hebrew acronym) to be sold only to the Bank of Israel, with the Bank selling them to, and buying them from, the public in order to regulate the money supply and carry out its functions. The government must deposit all proceeds from sales of these bills with the Bank of Israel and may not use them for any purpose other than repayment of the loan taken under said Law, or payment of the yield on it. The purchase of bills from the government by the Bank of Israel and the deposit of the proceeds of this sale with the Bank of Israel are not reflected in the Bank's balance sheet.

The balance of *makam* shown in the balance sheet reflects the redemption value of bills held by the public, less the balance of the unamortized discount.

14. Other liabilities

	December 31	
	2011	2010
	(NIS million)	
Pension and severance pay liabilities	3,897	3,771
Other liabilities on employees' rights	136	116
Binational funds	126	117
Accounts payable ^a	956	352
Total other liabilities	5,115	4,356

^a The balance mainly comprises accounts of statutory bodies that are managed in Bank of Israel.



a. Pension and severance pay liabilities

Pension liability is calculated according to the pension agreements with the Bank's employees and pensioners who commenced their employment before September 2002 and their survivors (on December 31, 2011—341 employees and 673 retirees; on December 31, 2010—368 employees, and 663 retirees). The pension liability includes future payment of benefits for Bank employees, former Bank employees whose pensions have been frozen, retirees, and survivors. It also includes obligations on account of the cash value of unused sick leave upon retirement and retirement grants.

The Bank's liability is calculated on the basis of salary and pension data for December 2011 and actuarial calculations. The calculation was performed using a method of estimating benefits which are accrued under various parameters: early retirement rates, pension rates for surviving spouses and orphans, employees' seniority and grade, relevant tax rates, etc.

The actuarial calculation is based on foreseen changes in white-collar mortality rates, in accordance with the Pension Fund Directives published by the Capital Market, Insurance, and Savings Division of the Ministry of Finance on May 17, 2007.

The Bank's actuarial liability was calculated on the basis of a 4 percent discount rate, in accordance with the public reporting directives of the Supervisor of Banks and based on past experience. The calculation assumes a real annual wage increase of up to 1.5 percent.

For Bank employees who commenced their employment after September 2002, the Bank's liability for pension and severance pay is covered by regular deposits with a recognized pension and severance-pay fund on behalf of the individual employee. Since sums deposited in said manner are neither controlled nor managed by the Bank, neither they nor the liabilities against which they were deposited are reflected in the balance sheet.

b. Liability for employees' and other rights

This item consists mainly of an NIS 96 million liability for employees' vacation (in 2010—NIS 92 million.)

The liability at December 31 is calculated on the basis of the accrued vacation days due at October 31 and the effective salary for vacation redemption at the balance sheet date. The difference in the liability that derives from the accrual of vacation days between October 31 and December 31 is immaterial.



15. Revaluation accounts

Revaluation accounts include unrealized profits from the revaluation of the following items (see Notes 1.g, 1.m, and 1.n):

	December 31	
	2011	2010
	(NIS million)	
Foreign currency balances	16,938	317
Tradable foreign currency securities	998	742
Tradable local currency securities	1,377	1,145
Total revaluation accounts	19,313	2,204

16. Share capital and general reserves in historical nominal values

Data on the Bank's share capital and general reserve appear in the financial statements in reported values. (See Note 1.c.). The amount in historical nominal values is NIS 320 million at December 31, 2011 and 2010.

The general reserve served in the past to increase the Bank's capital in accordance with Section 6 of the Bank of Israel Law, 5714-1954.

17. Assets and liabilities according to indexation bases

	December 31, 2011				December 31, 2010			
	In local currency	In foreign currency ^a	Nonfinancial items	Total	In local currency	In foreign currency ^a	Nonfinancial items	Total
	(NIS million)				(NIS million)			
Assets								
Foreign-currency assets abroad	-	286,981	-	286,981	-	252,553	-	252,553
Credit to the government	-	126	-	126	-	117	-	117
Tradable securities in local currency	19,595	-	-	19,595	19,672	-	-	19,672
Other assets	141	-	-	141	168	-	-	168
International financial institutions	-	-	923	923	-	-	926	926
Fixed assets	-	-	296	296	-	-	278	278
Total assets	19,736	287,107	1,219	308,062	19,840	252,670	1,204	273,714
Liabilities								
Banknotes and coins in circulation	48,975	-	-	48,975	44,828	-	-	44,828
Foreign currency liabilities abroad	-	884	-	884	-	882	-	882
Government deposits	10,568	2,008	-	12,576	12,979	1,228	-	14,207
Deposits of banking corporations	129,438	2,410	-	131,848	99,857	1,541	-	101,398
International financial institutions	-	5,190	-	5,190	-	4,890	-	4,890
<i>Makam</i>	121,532	-	-	121,532	134,909	-	-	134,909
Other liabilities	4,989	126	-	5,115	4,239	117	-	4,356
Revaluation accounts	1,377	17,936	-	19,313	1,145	1,059	-	2,204
Total liabilities	316,879	28,554	-	345,433	297,957	9,717	-	307,674
Difference	(297,143)	258,553	1,219	(37,371)	(278,117)	242,953	1,204	(33,960)

^a Including foreign currency indexed.





18. Contingent liabilities^a and commitments

	31 December	
	2011	2010
	(NIS million)	
Off-balance-sheet financial instruments		
Guarantees for government exports	51	233
Documentary credit	125	-
Liabilities to pay international financial institutions on demand	3,214	3,024
Liabilities to pay International Monetary Fund on demand ^b	2,734	2,741
Liabilities to purchase shares from international financial institutions ^c	420	-
Commitments in respect of financial instruments		
Currency swaps and forward transactions		
Future receipts of foreign currency	28,851	21,620
Future payments of foreign currency	27,894	22,478
Repurchase Agreements (Repo) and Reverse Repurchase Agreements (R.Repo)		
R.Repo	15,792	1,784
Futures transactions on bonds—in face value terms		
Sales commitments	-	320

^a Several claims are pending against the Bank of Israel. However, it is the Bank's opinion, based on the opinion of the Bank's Legal Department, that the probability of these claims being upheld is low, or that the sums involved are not significant.

^b See Note 3.a.

^c See Note 7.

19. Interest income from financial assets in foreign currency abroad

	For the year ended December 31	
	2011	2010
	(NIS million)	
Demand deposits	3	4
Short-term deposits	46	33
Tradable securities	2,662	2,900
Securities purchased under R.Repo agreements	20	21
Derivative financial instruments, net	31	(15)
IMF	25	16
Total interest income from assets in foreign currency abroad	2,787	2,959

Interest income from (expense on) foreign exchange reserves

The following shows the composition of interest income from (expense on) foreign exchange reserves. (see Notes 2 and 22.)

	For the year ended December 31	
	2011	2010
	(NIS million)	
Interest income from foreign currency assets abroad	2,787	2,959
Less interest expense on foreign currency liabilities abroad	(9)	(4)
Total income from foreign exchange reserves	2,778	2,955

20. Interest income from the government

	For the year ended December 31	
	2011	2010
	(NIS million)	
Long-term unindexed advances ^a	-	2
From binational funds	74	72
From local currency securities	702	948
Total	776	1,022

^a See Note 4.

21. Other interest income

This item consists of interest income from banks in respect of balances carrying the Bank of Israel interest rate.

22. Interest expense on financial liabilities in foreign currency abroad

This item consists of interest expense in respect of securities sold within the framework of repurchase agreements. (see Note 19.)



23. Interest expense to banks and the public

	For the year ended December 31	
	2011	2010
	(NIS million)	
<i>Makam</i>	3,275	2,234
Time deposits	2,922	1,266
Total	6,197	3,500

24. Interest expense to the government

	For the year ended December 31	
	2011	2010
	(NIS million)	
On account of local currency balances ^a	624	318
On account of foreign currency balances	1	10
Total	625	328

^a The expense of local currency interest paid to the government includes interest expense on government balances for financing the budget.

25. Other interest expense

This item consists mainly of interest expense to international financial institutions, on deposits of the US-Israel Binational Industrial Research and Development Foundation, on deposit of the US-Israel Binational Science Foundation, and expenses with respect to the National Insurance Institute and the Postal Bank.



26. Other financial income from (expense on) securities and derivatives

	For the year ended December 31	
	2011	2010
	(NIS million)	
Securities In foreign currency ^a	319	36
Derivative financial instruments in foreign currency ^b	(64)	(105)
Total	255	(69)

^a Gain from the sale of securities and loss from reduction in their value at the end of the year, net.
^b Including financial income from (expense on) the realization of derivative financial instruments.

27. Other financial income from (expense on) exchange rate differentials

This item consists of realized exchange rate differentials on account of balances denominated in foreign currency. (see Notes 1.m and 1.n.)

28. Other financial income (expense)—miscellaneous

	For the year ended December 31	
	2011	2010
	(NIS million)	
In local currency ^a	4	223
In foreign currency	(17)	(12)
Total^b	(13)	211

^a In 2010 the amount included income in an amount of NIS 220 million in respect of Series A NIS banknotes and coins of a value of 5 agorot that are held by the public and were not exchanged. (See Note 9.)
^b The other income (expenses) is from fees from the Bank of Israel's financial activities.



29. Administrative and general expenses

	For the year ended December 31	
	2011	2010
	(NIS million)	
Staff wages and employees' rights ^a	275	268
Pension and retirement ^b	341	182
General expenses ^c	90	78
Total	706	528

^a Salaries and provision for employees' vacation (683 employee posts on December 31, 2011 and 708 employee posts on December 31, 2010).

^b Unfunded (non-contributory) pension payments to pensioners and an update of the Bank's liability for pension and retirement payments (total balance, after the update, was NIS 3,897 million at balance sheet date. See Note 14.)

^c The item comprises, inter alia, expenses relating to the professional services of the Bank's external auditors. The auditor's fees from auditing the financial statements for 2010 constitute 62% of the auditor's total fees from the Bank in 2011.

30. Other income

This item consists of dividend income and the effect of changing the method for measuring the cost of investments in reported values in international financial institutions and the resulting change in estimates. (See footnote 2 in Note 7.)