FORMULA SYSTEMS (1985) LTD
Form 20-F/A
June 14, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 20-F/A
Amendment No. 1

o 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, 2010

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from __________ to ___________

OR

o 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)

Israel
(Jurisdiction of Incorporation or Organization)

5 Haplada Street, Or Yehuda 60218, Israel
(Address of Principal Executive Offices)

Guy Bernstein, CEO, 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
Ordinary Shares, NIS 1 par value	Tel Aviv Stock Exchange
American Depositary Shares	NASDAQ Global 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

As of December 31, 2010, the registrant had 13,596,000 outstanding ordinary shares, NIS 1 par value, of which 1,035,593 were represented by American Depositary Shares as of such date.

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

Yes o 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 o 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 o

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 o No o

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:

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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 o No x

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EXPLANATORY NOTE

This Amendment No. 1 (the "Amendment") to the Annual Report on Form 20-F for the year ended December 31, 2010, filed on March 18, 2011 with the Securities and Exchange Commission (the "Original Report"), is being filed by Formula Systems (1985) Ltd. ("Formula" or the "Company"), to amend the Original Report for the sole purposes of: (i) revising the disclosure in paragraph (a)(1)(i) under Item 16F ("Change in Registrant's Certifying Accountant") to re-characterize the cause of the change in the Company's principal accountant effective as of the second quarter of 2010 as a dismissal of the Company's former principal accountant (the "Former Accountant"); (ii) filing once again, as an exhibit to the Amendment (as Exhibit 15.8 to the Amendment, in replacement of Exhibit 15.7 to the Original Report), a letter from the Former Accountant in which it expresses agreement with the revised disclosure set forth in Item 16F(a) of the Amendment (i.e., including the revised statement concerning the dismissal of the Former Accountant described in clause (i) immediately above); (iii) adding to the Company's current auditor's report on the Company's consolidated financial statements and the other reports of auditors of the Company's subsidiaries that were filed pursuant to Item 18 of Form 20-F the report of the Former Accountant on the Company's consolidated financial statements as of December 31, 2009 and for the two year period then ended (the "Former Accountant Audit Report"), in accordance with Rule 2-05 of Regulation S-X promulgated by the Securities and Exchange Commission; and (iv) filing, as a new exhibit (Exhibit 15.7 to the Amendment) the consent of the Former Accountant to the incorporation by reference of the Former Accountant Audit Report (as included in the Amendment) in the Company's Registration Statement on Form S-8 (No. 333-156686).

Other than as set forth herein, this Amendment does not, and does not purport to, amend or restate any other information contained in the Original Report, nor does this Amendment reflect any events that have occurred after the Original Report was filed. The filing of this Amendment shall not be deemed an admission that the Original Report, when filed, included any untrue statement of a material fact or omitted to state a material fact necessary to make a statement not misleading.

Capitalized terms appearing in this Amendment which are not otherwise defined shall have the respective meanings assigned to them in the Original Report.

ITEM 16F. CHANGE IN REGISTRANT'S CERTIFYING ACCOUNTANT

(a)(1)(i) Effective as of the second quarter of 2010, Ziv Haft was dismissed as our independent auditor, following its audit of our consolidated financial statements for the year ended December 31, 2009.

(ii) The reports of Ziv Haft on our financial statements for each of the two fiscal years ended December 31, 2009 and 2008 did not contain an adverse opinion or a disclaimer of opinion and were not qualified or modified as to uncertainty, audit scope, or accounting principles.

(iii) In keeping with the requirements of the Companies Law, our decision to change accountants was recommended and/or approved by each of (a) the audit committee of our board of directors, (b) our board of directors and (c) our shareholders. Pursuant to the Companies Law, the opinion of our audit committee with regard to the non-renewal of the services of Ziv Haft was presented at our 2010 annual general meeting of shareholders held on August 11, 2010, which opinion was formulated after Ziv Haft was given an opportunity to present its position to our audit committee.

(iv) During each of the two fiscal years ended December 31, 2009 and 2008 and through the interim period preceding the non-continuation of Ziv Haft's services, there were no disagreements with Ziv Haft on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which, if not resolved to the satisfaction of Ziv Haft, would have caused Ziv Haft to make reference to the matter in connection with its reports.

(v) During each of the two fiscal years ended December 31, 2009 and 2008 and through the interim period preceding the non-continuation of Ziv Haft's services, none of the reportable events listed in paragraphs (a)(1)(v)(A) through (D) of Item 16F of the SEC's Form 20-F occurred.

(2) Based on the recommendation and/or approval by each of (a) the audit committee of our board of directors, (b) our board of directors and (c) our shareholders (shareholder approval was obtained at our 2010 Annual General Meeting of shareholders held on August 11, 2010), Kost Forer was engaged as our new independent auditor for the fiscal year ending December 31, 2010, effective as of the start of our 2nd fiscal quarter of 2010. Prior to its engagement, we did not consult with Kost Forer regarding matters or events set forth in paragraphs (a)(2)(i) or (a)(2)(ii) of Item 16F of the SEC's Form 20-F.

(3) We have provided Ziv Haft with a copy of the disclosures that we have made in response to this Item 16F(a) and requested that Ziv Haft furnish us with a letter addressed to the SEC stating whether it agrees with the above statements made by us in response to this Item 16F(a) and, if not, stating the respects in which it does not agree with such statements. Ziv Haft's response letter is filed as Exhibit 15.8 to this Amendment No. 1 to our annual report on Form 20-F.

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 annual report (as amended), as noted on the pages below:

In addition, the reports of (i) Ziv Haft, which audited our consolidated financial statements as of December 31, 2009 and for the two fiscal years then ended, and (ii) the independent accounting firms that have audited the financial statements of certain of our subsidiaries for the fiscal year ended, and as of, December 31, 2010, whose audits are in each case referenced by our independent registered public accounting firm in its report on our consolidated financial statements included herein, have also been filed as part of this annual report (as amended).

ITEM 19. EXHIBITS

Exhibit No.	
1.1	Memorandum of Association (1)
1.2	Articles of Association as amended on December 28, 2005 (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, dated December 28, 2005 (2)
4.2	English translation of Formula Systems (1985) Ltd. Employees and Office Holders Share Option Plan (2008)(3)
8	List of Subsidiaries*
12.1	Certification of the Chief Executive Officer and 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 and 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 & Kasierer, 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 Verstegen accountants en adviseurs*
15.5	Consent of KDA Audit Corporation*
15.6	Consent of Maria Negyessy*
15.7	Consent of Ziv Haft, registered certified public accountants (Isr.) BDO member firm**
15.8	Letter dated June 14, 2011 of Ziv Haft, registered certified public accountants (Isr.) BDO member firm, required to be filed under Item 16F(a)(3) of this annual report**

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* Previously filed, as an exhibit to the original annual report on Form 20-F for the 2010 fiscal year filed by the registrant with the Securities and Exchange Commission on March 18, 2011.

* * 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 the annual report on Form 20-F for the 2005 fiscal year filed by the registrant with the Securities and Exchange Commission on June 29, 2006.
(3) 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 its annual report on its behalf.

FORMULA SYSTEMS (1985) LTD.

By:	/s/Guy Bernstein Guy Bernstein Chief Executive Officer	June 14, 2011 Date

EXHIBIT INDEX

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FORMULA SYSTEMS (1985) LTD.

(An Israeli corporation)

2010 Annual Report

FORMULA SYSTEMS (1985) LTD.
(An Israeli Corporation)

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2010

U.S. DOLLARS IN THOUSANDS

INDEX

Kost Forer Gabbay & Kasierer
3 Aminadav St.
Tel-Aviv 67067, Israel

Tel: 972 (3)6232525
Fax: 972 (3)5622555
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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 the accompanying consolidated balance sheet of Formula Systems (1985) Ltd. and its subsidiaries (the "Company") as of December 31, 2010 and the related consolidated statements of income, changes in shareholders' equity and cash flows for the year then ended. 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 2% as of December 31, 2010, and total revenues of 4%, for the year then ended, 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.

The financial statements of the Company as of December 31, 2009 and for each of the two years in the period ended December 31, 2009, were audited by another auditor who expressed an unqualified opinion on those financial statements in his report dated April 29, 2010.

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 at December 31, 2010 and the consolidated results of their operations and their cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States.

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, 2010, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 18, 2011 expressed an unqualified opinion thereon.

/s/ Kost, Forer, Gabbay & Kasierer

Tel-Aviv, Israel
March 18, 2011

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, 2010, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Formula's management is responsible for maintaining effective internal control over financial reporting in the accompanying Management's Annual 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.

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As indicated in the accompanying Management's Report on Internal Control over Financial Reporting, management's assessment of and conclusion on the effectiveness of internal control over financial reporting did not include the internal controls of Fusion Solutions LLC. which is included in the 2010 consolidated financial statements of Formula Systems (1985) Ltd. and which constituted 1.7% of consolidated total assets and 0.7% of consolidated shareholders' equity as of December 31, 2010, and 6.2% of consolidated revenues and 6.8% of consolidated net income from continuing operations for the year then ended. Our audit of internal control over financial reporting of Formula Systems (1985) Ltd. also did not include an evaluation of the internal control over financial reporting of Fusion Solutions LLC.

In our opinion, Formula maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Formula and its subsidiaries as of December 31, 2010 and the related consolidated statements of operations, changes in equity and cash flows for the year then ended and our report dated March 18, 2011 expressed an unqualified opinion thereon.

The financial statements of the Company as of December 31, 2009 and for each of the two years in the period ended December 31, 2009, were audited by another auditor who expressed an unqualified opinion on those financial statements in his report dated April 29, 2010.

/s/ Kost, Forer, Gabbay & Kasierer
KOST, FORER, GABBAY & KASIERER
A Member of Ernst & Young Global

Tel-Aviv, Israel
March 18, 2011

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FORMULA SYSTEMS (1985) LTD.
(An Israeli Corporation)

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

	December 31, 2010	December 31, 2009
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	110,508	100,205
Marketable securities (Note 4)	38,170	44,171
Short-term deposits	24	13,838
Trade receivables (net of allowances for doubtful debts of $ 3,781 and $ 4,750 as of December 31, 2010 and 2009, respectively)	154,366	130,237
Other current assets (Note 16a)	23,140	22,448
Inventories	5,601	2,439
Total assets attributed to discontinued operations	-	27
	331,809	313,365
LONG-TERM INVESTMENTS:		
Marketable Securities (Note 4)	2,828	7,381
Deferred taxes (Note 15b)	13,135	9,499
Investments in affiliated company (Note 6)	3,209	3,710
Prepaid expenses and other assets	5,493	3,423
	24,665	24,013
SEVERANCE PAY FUND	55,286	44,131
PROPERTY, PLANTS AND EQUIPMENT, NET (Note 7)	12,411	9,989
NET INTANGIBLE ASSETS (Note 9)	33,101	27,534
GOODWILL (Note 8)	166,495	147,407
	623,767	566,439

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

FORMULA SYSTEMS (1985) LTD.
(An Israeli Corporation)

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

	December 31, 2010	December 31, 2009
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Liabilities to banks (Note 16b)	6,684	10,055
Trade payables	53,177	43,777
Deferred revenue	26,845	25,206
Employees and payroll accrual	40,704	32,029
Other accounts payable (Note 16c)	30,693	26,994
Dividend payable	-	6,694
Liability in respect of business combinations	3,963	210
Debentures (Note 11)	15,927	14,639
Liabilities attributed to discontinued operations	-	314
	177,993	159,918
LONG-TERM LIABILITIES:		
Debentures (Note 11)	31,854	43,918
Deferred taxes (Note 15e)	2,654	2,207
Customer advances	3,520	1,116
Liabilities to banks and others (Note 10)	3,154	8,556
Liability in respect of business combinations	4,758	1,517
Accrued severance pay	65,450	53,893
	111,390	111,207
COMMITMENTS AND CONTINGENCIES (Note 13)		
SHAREHOLDERS' EQUITY (Note 14):		
Formula shareholders' equity:		
Share capital - ordinary shares of NIS 1 par value Authorized - December 31, 2010 and 2009 - 25,000,000 shares; Issued: December 31, 2010 - 13,620,780 and 2009 - 13,224,780 shares)	3,807	3,736
Additional paid-in capital	136,222	131,631
Retained earnings	58,441	60,048
Other accumulated comprehensive loss	(596)	(7,115)
Treasury shares (24,780 shares as of December 31, 2010 and 2009)	(259)	(259)
Total Formula shareholders' equity	197,615	188,041
Non-controlling interests	136,769	107,273
TOTAL SHAREHOLDERS' EQUITY	334,384	295,314

	623,767	566,439

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

FORMULA SYSTEMS (1985) LTD.
(An Israeli Corporation)

CONSOLIDATED STATEMENTS OF INCOME

U.S. dollars in thousands, except per share amounts

	Year ended December 31,		
	2010	2009	2008
Revenues (Note 16g)			
Proprietary software products	98,498	88,815	92,560
Software services	451,196	380,575	410,683
Total revenues	549,694	469,390	503,243
Cost of revenues			
Proprietary software products	46,297	43,057	43,246
Software services	366,166	309,226	330,529
Total cost of revenues	412,463	352,283	373,775
Gross profit	137,231	117,107	129,468
Research and development costs, net	5,503	4,430	6,564
Selling, general and administrative expenses	84,510	77,322	90,451
Other expenses (income), net	231	(1,668)	580
Operating income	46,987	37,023	31,873
Financial expenses, net (Note 16d)	(4,371)	(231)	(5,908)
Losses on realization of investments, net	-	-	(337)
Income before taxes on income	42,616	36,792	25,628
Taxes on income (Note 15)	(6,544)	(8,305)	(3,279)
	36,072	28,487	22,349
Equity in losses of affiliated company, net	(1,070)	(335)	(216)
Income from continuing operation	35,002	28,152	22,133
Net income from discontinued operations (Note 17d)	-	4,878	555
Net income	35,002	33,030	22,688
Net income Attributable to non-controlling interests	16,623	13,954	10,819
Net income attributable to Formula's shareholders	18,379	19,076	11,869
Amount attributable to Formula's shareholders			
Income from continuing operation	18,379	14,198	11,314

Income from discontinued operation	-	4,878	555
	18,379	19,076	11,869
Earnings per share generated from continuing operation:			
Basic	1.37	1.08	0.84
Diluted	1.36	1.04	0.84
Earnings per share generated from discontinued operations:			
Basic	-	0.37	0.04
Diluted	-	0.36	0.04
Total earnings per share:			
Basic	1.37	1.44	0.88
Diluted	1.36	1.40	0.88
Weighted average number of shares outstanding in thousands (Note 16h):			
Basic	13,382	13,200	13,200
Diluted	13,523	13,564	13,200

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

FORMULA SYSTEMS (1985) LTD.
(An Israeli Corporation)

CONSOLIDATED STATEMENTS OF CHANGES IN SHARHOLDERS' EQUITY

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

	Share Capital Number	Amount	Additional paid-in capital	Retained earnings	Accumulated other comprehensive loss	Cost of treasury shares	Total Formula ' shareholders' Equity	Non-controlling interests
Balance as of January 1, 2008	13,200,000	3,736	132,545	69,229	(6,863)	(259)	198,388	107,915
Changes during 2008:								
Net Income	-	-	-	11,869	-	-	11,869	10,819
Unrealized loss from available - for-sale securities, net	-	-	-	-	(1,123)	-	(1,123)	(20)
Adjustment for other than temporary impairment on marketable securities	-	-	-	-	27	-	27	20
Foreign Currency translation adjustments	-	-	-	-	859	-	859	1,164
Total comprehensive income	-	-	-	-	-	-	11,632	
Gain from issuance of shares to third party in a development stage entity	-	-	43	-	-	-	43	43
Stock Based Compensation expenses	-	-	-	-	-	-	-	1,161
Changes in non-controlling interests due to holding changes	-	-	-	-	-	-	-	(9,483)
Exercise of employees stock options	-	-	-	-	-	-	-	1,426
Dividend to Formulas'' shareholders and to non-controlling interests in subsidiaries	-	-	-	(40,126)	-	-	(40,126)	(5,612)
Balance as of December 31, 2008	13,200,000	3,736	132,588	40,972	(7,100)	(259)	169,937	107,433
Changes during 2009:								
Net Income	-	-	-	19,076	-	-	19,076	13,954
	-	-	-	-	3	-	3	2

Unrealized gain from derivative instruments, net								
Unrealized gain (loss) from available - for-sale securities, net	-	-	-	-	(66)	-	(66)	74
Other temporary impairment					(250)		(250)	
Foreign Currency translation adjustments	-	-	-	-	298	-	298	413
Total comprehensive income							19,061	
Stock Based Compensation expenses	-	-	308	-	-	-	308	1,333
Non-controlling interests changes due to holding changes including exercise of employees stock options	-	-	(1,265)	-	-	-	(1,265)	(842)
Dividend to non-controlling interests in subsidiaries	-	-	-	-	-	-	-	(15,094)
Balance as of December 31, 2009	13,200,000	3,736	131,631	60,048	(7,115)	(259)	188,041	107,273

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

FORMULA SYSTEMS (1985) LTD.
(An Israeli Corporation)

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

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

	Share Capital Number	Share Capital Amount	Additional paid-in capital	Retained earnings	Accumulated other comprehensive loss	Cost of treasury shares	Total Formula ' shareholders' Equity	Non-controlling interests
Changes during 2010:								
Net Income	-	-	-	18,379	-	-	18,379	16,623
Unrealized gain from derivative instruments, net	-	-	-	-	4	-	4	3
Unrealized gain (loss) from available - for-sale securities, net	-	-	-	-	180	-	180	(21)
Realized gain from available-for-sale securities	-	-	-	-	250	-	250	
Foreign Currency translation adjustments	-	-	-	-	6,085	-	6,085	4,793
Total comprehensive income					6,519		24,898	
Stock Based Compensation expenses	-	-	458	-	-	-	458	1,006
Exercise of employees stock options	396,000	71	(71)	-	-	-	-	-
Non controlling interests changes due to holding changes including exercise of employees stock options			6,258	-	-	-	6,258	16,068
Acquisition of non-controlling interests			(2,054)				(2,054)	(1,711)
Dividend to Formula's shareholders and to non-controlling interests in subsidiaries	-	-	-	(19,986)	-		(19,986)	(7,265)
Balance as of December 31, 2010	13,596,000	3,807	136,222	58,441	(596)	(259)	197,615	136,769

Year ended December 31,		
2010	2009	2008

Accumulated unrealized loss from available - for-sale securities	(954)	(1,384)	(1,068)
Accumulated currency translation adjustments	351	(5,734)	(6,032)
Accumulated Unrealized gain from derivative instruments	7	3	-
Accumulated other comprehensive income (loss)	596	(7,115)	(7,100)

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

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FORMULA SYSTEMS (1985) LTD.
(An Israeli Corporation)

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2010	2009	2008
Cash flows from operating activities:			
Net income	35,002	33,030	22,688
Adjustments to reconcile net income to net cash provided by operating activities:			
Impairment and write down of other investments and fixed assets	-	59	502
Impairment of available for sale marketable securities	292	143	-
Equity in losses of affiliated company	1,070	335	216
Depreciation and amortization	15,451	14,605	13,082
Amortization of convertible debt discount, increase in value and current interest	1,728	-	-
Increase (decrease) in accrued severance pay, net	(148)	(1,618)	4,984
Gain from sale of operation and subsidiaries	(146)	(4,389)	-
Loss (gain) from sale of property, plants and equipment	1	(2,219)	(341)
Loss (gain) on realization of shareholdings and operations	-	-	337
Stock-based compensation expenses	1,464	1,641	1,505
Changes in financial liabilities, net	325	(202)	4,950
Loss (gain) from repurchase of convertible debt, net	-	2	(218)
Changes in value of long term loans and deposits, net	64	(210)	(129)
Changes in deferred taxes, net	(3,355)	665	(1,881)
Change in liability in respect of business combinations	265	458	(558)
Loss (gain) from sale and decrease (increase) in value of marketable securities classified as trading	630	(2,609)	1,481
Proceeds from derivatives	2,423	-	-
Changes in operating assets and liabilities:			
Decrease (increase) in inventories	(3,007)	340	446
Decrease (increase) in trade receivables	(9,500)	13,057	(8,241)
Decrease (increase) in other accounts receivable	(1,129)	12,478	3,914
Increase (decrease) in trade payables	5,666	1,604	(2,602)
Increase (decrease) in other accounts payable	925	(12,875)	6,674
Increase in customer advances	5,351	1,345	575
Net cash provided by operating activities	53,372	55,640	47,384

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

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FORMULA SYSTEMS (1985) LTD.
(An Israeli Corporation)

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2010	2009	2008
Cash flows from investing activities:			
Acquisition of newly-consolidated subsidiaries and activities (Appendix C)	(13,975)	(1,262)	(13,633)
Proceeds from realization of investment in previously-consolidated subsidiaries (Appendix D)	-	3,482	-
Proceeds from sale of activity in a consolidated company	146	105	-
Proceeds from sale of affiliates company	-	-	150
Proceeds from sale of subsidiary's operation	-	-	15,506
Changes in restrictions on short term deposit	-	4,040	(4,040)
Restricted short term deposit, net	400	-	-
Purchase of property and equipment	(5,348)	(2,713)	(4,055)
Proceeds from (investment in) marketable securities, net	12,246	3,064	(6,795)
Proceeds from sale of property, plants and equipment	446	5,666	1,011
Investment in and loans to affiliates and other companies	(1,160)	-	(187)
Other investments	(282)	-	(756)
Payments to former shareholders of consolidated company	(121)	(6,455)	(5,973)
Changes in short term deposits, net	13,445	(11,945)	(1,659)
Proceeds from long term bank deposits	-	139	3,090
Capitalization of software development and other costs	(9,186)	(6,960)	(6,683)
Purchase of non-controlling interests in subsidiaries	-	-	(16,983)
Net cash used in investing activities	(3,389)	(12,839)	(41,007)

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

FORMULA SYSTEMS (1985) LTD.
(An Israeli Corporation)

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2010	2009	2008
Cash flows from financing activities:			
Exercise of employees stock options in subsidiaries	1,850	1,224	876
Dividend paid to non-controlling interests in subsidiaries	(13,959)	(8,400)	(5,612)
Dividend to Formula's shareholders	(19,986)	(29,964)	(10,162)
Short-term bank credit, net	(229)	(247)	(15,151)
Repayment of long-term loans from banks and others	(7,574)	(8,616)	(10,855)
Receipt (payment) of short-term loans	(3,381)	1,580	(750)
Share issuance in a subsidiary to non-controlling interest, net	20,290	-	-
Purchase of non-controlling interests	(3,768)	(3,774)	-
Proceeds from SWAP transactions	-	1,061	-
Repayment and repurchase of debenture	(15,927)	(5,824)	(18,128)
Net cash used in financing activities	(42,684)	(52,960)	(59,782)
Effect of exchange rate changes on cash and cash equivalents	3,004	(238)	2,481
Net increase (decrease) in cash and cash equivalents	10,303	(10,397)	(50,924)
cash and cash equivalents at beginning of year(*)	100,205	110,602	161,526
Cash and cash equivalents at end of year (*)	110,508	100,205	110,602

(*) Include cash and cash equivalents of discontinued operations.

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

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FORMULA SYSTEMS (1985) LTD.
(An Israeli Corporation)

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

		Year ended December 31,		
		2010	2009	2008
a.	Supplemental cash flow information::			
	Cash paid in respect of:			
	Interest	3,847	4,064	5,077
	Income tax	7,356	4,444	5,192
b.	Non-cash activities:			
	Dividend payable to Formula's shareholders and to non-controlling interests in subsidiaries	-	6,694	29,964
	Assets retirement obligation	-	275	-
	Receivables from sale of property	-	450	-
c.	Acquisition of newly-consolidated subsidiaries and activities:			
	Assets and liabilities of subsidiaries consolidated as of acquisition date:			
	Working capital (other than cash and cash equivalents)	(3,341)	-	(6,209)
	Property and equipment	(304)	-	(543)
	Goodwill and intangible assets	(18,040)	(1,262)	(15,845)
	Long-term liabilities	5,199	-	395
	Other long term assets	717	-	-
	Long term deferred tax liability	(173)	-	1,771
	Liability to formerly shareholders	-	-	6,723
	Non-controlling interests at acquisition date	1,967	-	75
	Total	(13,975)	(1,262)	(13,633)
d.	Proceeds from realization of investments in previously-consolidated subsidiaries:			
	Working capital (other than cash and cash equivalents)	-	(2,259)	-
	Property and equipment	-	144	-
	Other assets, deferred expenses and long term payables	-	1,337	-
	Goodwill	-	206	-
	Adjustment to other comprehensive (loss) gain	-	(230)	-
	Gain from realization of investments in subsidiaries	-	4,284	
	Total	-	3,482	-

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

FORMULA SYSTEMS (1985) LTD.
(An Israeli Corporation)

NOTES TO 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 in 1985. Since 1991, Formula's shares have been traded on the Tel Aviv Stock Exchange ("TASE") and since 1997, through American Depositary Shares ("ADS") under the symbol FORTY on the Global Market in the United States ("NASDAQ"). Each ADS represents one ordinary share of Formula.

Formula, through its subsidiaries (collectively, the "Company" or the "Group") is engaged in the development, production and marketing of information technology ("IT") solutions and services. The Group operates through its three subsidiaries in two reportable segments: IT Services and Proprietary Software Solutions. For a description of the Company's operations see Note 16G.

b. The following table presents certain information regarding the control and ownership of Formula's significant subsidiaries, as of the dates indicated:

	Percentage of ownership and control December 31,	
	2010	2009
Name of subsidiary		
Matrix IT Ltd. ("Matrix")	50.1	50.1
Magic Software Enterprises Ltd. ("Magic")	51.7	58.1
Sapiens International Corporation N.V. ("Sapiens")	71.6	70.4

The above list consists only of active companies that are held directly by Formula.

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").

b. Use of estimates:

The preparation of 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. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

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FORMULA SYSTEMS (1985) LTD.
(An Israeli Corporation)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

c. Financial statements in U.S. dollars:

The functional currencies of Formula's subsidiaries are NIS and U.S. dollars. Formula has elected to use U.S. dollar as its reporting currency for all years presented.

Formula translates the financial statements of its subsidiary whose functional currency is NIS, into U.S. dollars, under the principles described in ASC 830. Assets and liabilities have been translated at period-end exchange rates. Results of operations have been translated at the exchange rate at the dates on which those transactions occurred or at an average rate. Formula presents differences resulting from translation in equity under "accumulated other comprehensive income (loss)".

d. Principles of consolidation:

The consolidated financial statements include Formula's financial statements as well as those of its subsidiaries in which it has controlling interests. All intercompany balances and transactions have been eliminated upon consolidation.

Non-controlling interests of subsidiaries represent the non-controlling shareholders' 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.

e. Cash equivalents:

Cash equivalents are considered by the Company to be highly-liquid investments, including, inter-alia, short-term deposits with banks, which the maturity dates are less than three months at the time of acquisition and which are unrestricted.

f. Short-term deposits:

Short-term deposits are deposits with maturities of more than three months but less than one year. Short-term deposits are presented at their costs including accrued interest.

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.

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FORMULA SYSTEMS (1985) LTD.
(An Israeli Corporation)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

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.

Unrealized gains and losses from marketable securities classified as "trading" are reported in the statements of operations. Investments are periodically reviewed to determine whether other-than-temporary impairment in value has occurred, in which case the investment is written down to its fair value, through the statements of operations.

Declines in fair value of available-for-sale equity securities that are considered other-than-temporary, based on criteria described in SAB Topic 5M, "Other Than Temporary Impairment of Certain Investments in Equity Securities", are charged to earnings. 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, and the intent and ability of the Company to retain its investment for a period of time sufficient to allow for any anticipated recovery in market value.

For declines in value of debt securities, effective January 1, 2009, the Company applies an amendment to ASC 320. Under the amended impairment model, other-than-temporary impairment loss is deemed to exist and 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 temporary impaired.

For debt securities that are deemed other-than-temporarily impaired, the amount of impairment recognized in the statement of operations 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. No such impairments have been recognized in all period presented.

FORMULA SYSTEMS (1985) LTD.
(An Israeli Corporation)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

h. Inventories:

Inventories are mainly comprised of hardware. Inventories are valued at the lower of cost or market value. Cost is determined on the "first in - first out" basis.

i. Investments in affiliates:

Affiliates are companies over which significant influence is exercised, but which are not consolidated subsidiaries, and are accounted for by the equity method, net of write-down for decrease in value, which is not of a temporary nature.

j. Property, plant and equipment, net:

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

	%
Computers and equipment	7-33 (mainly 33%)
Motor vehicles	15
Buildings	2-4
Leasehold improvements	*-)

*) Over the shorter of the term of the lease or the estimated useful life of the asset.

k. Intangible assets:

Intangible assets are comprised of software development costs and from other intangible assets:

1. Software development costs:

Development costs of software which is intended for sale, that are incurred after the establishment of technological feasibility of the relevant product, are capitalized.
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 Company's and its subsidiaries' technological feasibility is established upon completion of a detailed program design or working model.

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FORMULA SYSTEMS (1985) LTD.
(An Israeli Corporation)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Capitalized software costs are amortized on a product by product basis. Amortization equals the greater of the amount computed using the: (i) ratio of current gross revenues from sales of the software to the total of current and anticipated future gross revenues from sales of that software, or (ii) the straight-line method over the estimated useful life of the product (generally three to six years).

During the year ended December 31, 2010, consolidated subsidiaries capitalized software development costs aggregated to $ 9,100 (2009 - $ 6,800) and amortized capitalized software development costs aggregated to $ 9,100 (2009 - $ 8,400, 2008 - $ 7,000).

2. Other intangible assets:

Other intangible assets are comprised of customers related intangible assets and acquired technology and are amortized over their 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. Amortization is computed using the straight-line method as follows:

	%
Prepaid royalties	15 years
Distribution rights	5 years
Technology, usage rights and other intangible assets	3-8 years

The Company re-evaluates every year the remaining useful life of the intangible assets. During 2010, 2009 and 2008, no impairment was required.

l. Impairment of long-lived assets and intangible assets subject to amortization:

The Company'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 assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. During the years ended December 31, 2008, 2009 and 2010, no impairment were identified.

FORMULA SYSTEMS (1985) LTD.
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

m. Goodwill:

The Company applies ASC 350, "Intangible - Goodwill and Other". The Company performs its goodwill annual impairment test to its reporting units at December 31 of each year, or more often if indicators of impairment are present.

As required by ASC 350, the impairment test is accomplished using a two- step approach. The first step of the goodwill impairment test compares the fair value of a reporting unit with its carrying amount, including goodwill. The Company compares the fair value of each reporting unit to its carrying value ('step 1') and if the fair value exceeds the carrying value of the reporting unit net assets, goodwill is considered not impaired, and no further testing is required. If the carrying value exceeds the fair value of the reporting unit, then the implied fair value of goodwill is determined by subtracting the fair value of all the identifiable net assets from the fair value of the reporting unit. An impairment loss is recorded for the excess, if any; of the carrying value of goodwill over its implied fair value ('step 2').

At December 31, 2009, the market capitalization of one reporting unit was below its carrying value. The Company determines the fair value of this reporting unit using the Income Approach, which utilizes a discounted cash flow model, as it believes that this approach best approximates its fair value at this time. Assumptions related to revenue, gross profit, operating expenses, future short-term and long-term growth rates, weighted average cost of capital, interest, capital expenditures, cash flows, and market conditions are inherent in developing the discounted cash flow model. Additionally, the Company evaluated the reasonableness of the estimated fair value of its reporting unit by reconciling to its market capitalization.

The ability to reconcile the gap between the market capitalization and the fair value depends on various factors, some of which are quantitative, such as an estimated control premium that an investor would be willing to pay for a controlling interests in the Company, and some of which are qualitative and involve management judgment, including stable relatively high backlog and growing pipe line.

During the years ended December 31, 2010, 2009 and 2008, no impairment was required.

FORMULA SYSTEMS (1985) LTD.
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

n. Business combinations:

Effective January 1, 2009, the Company adopted the amended ASC 805, "Business Combinations". ASC 805 requires recognition of assets acquired, liabilities assumed, and non-controlling interest in the acquiree at the acquisition date, measured at their fair values as of that date. This ASC also requires the fair value of acquired in-process research and development ("IPR&D") to be recorded as intangibles with indefinite lives, contingent consideration to be recorded on the acquisition date, and restructuring and acquisition-related deal costs to be expensed as incurred. 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. In addition, changes in valuation allowance related to acquired deferred tax assets and in acquired income tax position are to be recognized in earnings.

ASC 805 is applied prospectively for all business combinations occurring after January 1, 2009, except for changes in valuation allowance related to deferred tax assets and changes in acquired income tax position originating from business combinations that occurred prior to the effective date of this ASC, which are recognized in earnings following the adoption date.

o. 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 is judgmental in nature 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 January 1, 2010, the Company adopted an updated guidance for the consolidation of variable interest entities. This new guidance replaces the prior quantitative approach for identifying which enterprise should consolidate a variable interest entity, which was based on which enterprise was exposed to a majority of the risks and rewards, with a qualitative approach, based on which 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 about whether an enterprise should consolidate a variable interest entity is required to be evaluated continuously as changes to existing relationships or future transactions. The adoption of this standard did not have a material impact on our financial position or results of operations.

FORMULA SYSTEMS (1985) LTD.
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The U.S. based consulting and staffing services business that the Company acquired through one of its wholly owned subsidiaries on January 17, 2010 is considered to be a VIE. The subsidiary 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.

p. Severance pay:

The Company's and its subsidiaries' obligation for severance pay with respect to their Israeli employees is calculated pursuant to the Israeli Severance Pay Law and employee agreements based on the most recent salary of the employees multiplied by the number of years of employment and are presented on an undiscounted basis. The severance pay liability to its employees pursuant to Israeli law and employment agreements is covered in part by managers' insurance policies, for which the Company and its Israeli subsidiaries makes monthly payments. These funds are recorded as assets in the Company's balance sheet. The Company can only make withdrawals from these funds for payments of severance pay.

The Company's and its Israeli subsidiary's agreements with certain of their Israeli employees are in accordance with Section 14 of the Severance Pay Law -1963. Payments in accordance with Section 14 release the Company from any future severance payments in respect of those employees. Deposits under Section 14 are not recorded as an asset in the Company's balance sheet.

Total expenses (gain) in respect of severance pay for the years 2010, 2009 and 2008 were $ 1,300, ($ 1,100) and $ 7,400, respectively.

q. Revenue Recognition:

The Company, through its subsidiaries, generate revenues primarily from the sale of IT services which includes: software products including maintenance, integration and infrastructure, training and deployment. In addition, the Company also generate revenues from the sale of software licenses and related maintenance and technical support as well as from related IT professional 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 after persuasive evidence of an arrangement exists, no significant Company obligations remain, collection of the resulting receivable is reasonably assured, and the fees are fixed or determinable.

FORMULA SYSTEMS (1985) LTD.
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Revenues derived from software license agreements are recognized in accordance ASC 985-605 "Software – revenue recognition", upon delivery of the software when collection is probable, where the license fee is otherwise fixed or determinable, and when there is persuasive evidence that an arrangement exists.

As required by ASC 985-605, the Company determines the value of 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 consulting and training services provided on hourly basis, are recognized as the services are rendered. Revenues from maintenance and support are recognized over the service period.

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

Revenues from license fees (included in the proprietary software products segment) that involve implementation and customization of the Company's software to customer specific requirements are generated by fixed-price or time-and-materials contracts. Revenues generated by fixed-price contracts are recognized in accordance with ASC 605-35 "Revenue Recognition - Construction-Type and Production-Type Contracts" using the percentage-of-completion method.

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 December 31, 2010, no estimated losses were identified.

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

FORMULA SYSTEMS (1985) LTD.
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Company 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 contracts and amounts received from customers but not yet recognized as revenues. Payments for maintenance fees are generally made in advance and are nonrefundable.

r. Provision for warranty:

In light of past experience, the Company does not record any provision for warranties in respect of their products and services.

s. Advertising costs:

The Company records advertising expenses as incurred. Advertising costs were recorded at the amount of $ 2,400, $ 2,400, and $ 5,500 in the years 2010, 2009, 2008 respectively.

t. Income taxes:

The Company and its subsidiaries account for income taxes in accordance with ASC 740, "Income Taxes". This Statement prescribes the use of the asset and liability method, whereby deferred tax assets and liability account balances are determined based on the differences between the 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. The Company and its subsidiaries provide a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value.

ASC 740 addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under ASC 740, a company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement.

The Group recognizes accrued interest and penalties related to unrecognized tax benefits as a component of income tax expense. The total amount of gross unrecognized tax benefits (taxes on income) for the years ended December 31, 2010, 2009 and 2008 was $ 2,106, $ 679 and $ 756, respectively.

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NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

u. Earnings per share:

Earnings per share ("EPS") are calculated in accordance with the provisions of ASC 260 "Earning per Share". ASC 260 requires the presentation of both basic and diluted EPS. Basic net earnings per share are calculated on the basis of the weighted average number of common shares outstanding during each year. The diluted earnings per share are calculated on the basis of the weighted average number of common shares outstanding during each year, plus the dilutive potential common shares considered outstanding during the year.

v. Treasury shares:

The Company repurchases its shares from time to time and hold them as a treasury shares. These shares are presented as a reduction of equity, at their cost. Gains and losses upon the sale of these shares, net of related income taxes, are recorded to additional paid-in capital.

w. Concentration of credit risks:

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 and marketable securities. The majority of the Company's cash and cash equivalents, bank deposits and marketable securities are invested with major banks in Israel, the United States and Europe. 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.

The Group's trade receivables are derived from sales to large organizations located mainly in Israel, North America and Europe. 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, the Company may require letters of credit, other collateral or additional guarantees. From time to time, the Company sells certain of its accounts receivable to financial institutions, within the normal course of business.

The Company 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 doubtful accounts expense for the years ended December 31, 2010, 2009 and 2008 was $ 487, $ 468 and $ 1,068, 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.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

ASC 860, "Transfers and Servicing", establishes a standard for determining when a transfer of financial assets should be accounted for as a sale. The underlying conditions are met for the transfer of financial assets to qualify for accounting as a sale. The transfers of financial assets are typically performed by the sale of receivables to a financial institution. There are no outstanding sales of receivables as of December 31, 2010, 2009 and 2008.

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.

x. Share-based compensation:

The Company accounts for share-based compensation in accordance with ASC 718, "Compensation - Stock Compensation". ASC 718 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 statement of income. The Company recognizes compensation expenses for the value of its awards, which have graded vesting based on the accelerated method over the requisite service period of each of the awards, net of estimated forfeitures.

Until 2009, certain of the Company's subsidiaries used the Black-Scholes option-pricing model to measure the fair values of the awards at the date of grant, which requires a number of assumptions, of which the most significant are, expected stock price volatility, and the expected option term. Commencing 2010, all subsidiaries used the Binomial option-pricing model ("the Binomial model") to measure the fair values of the awards at the date of grant. Expected volatility was calculated based upon actual historical stock price movements over the most recent periods ending on the grant date, equal to the expected option term. The expected option term represents the period that the Company's stock options are expected to be outstanding and was determined based on historical experience of similar options, giving consideration to the contractual terms of the stock options.

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

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NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Magic (the Binomial model):

	2010	2009	2008
Dividend yield	0%	0%	0%
Expected volatility	61.2% - 62.8%	63%	56% - 65%
Risk-free interest rate	2.53%-3.71%	2.73%-3.7%	1.83%
Expected forfeiture (employees)	9.7%	9.8%	11%
Expected forfeiture (executives)	7.1%	7.5%	8%
Contractual term of up to	10 years	10 years	10 years
Suboptimal exercise multiple (employees)	2.3	2.35	2.48
Suboptimal exercise multiple (executives)	3	3	3

Sapiens (Black-Scholes model for grants during 2008-2009):

	Year ended December 31,	
	2008	2009
Expected term	4.25 years	4.25 years
Dividend yield	0%	0%
Expected volatility	78%	90%- 93%
Risk-free interest rate	3%	1.8% - 2.5%

For grants of Sapiens' employees commencing January 1, 2010 (using the Binomial model):

	Year ended December 31, 2010
Contractual life of	6 years
Expected exercise factor	2.5
Dividend yield	0%
Expected volatility	65%-66%
Risk-free interest rate	2.3%-2.8%

There were no grants in Matrix during 2009 and 2010. During 2008, the Company granted 200,000 options using the following assumptions in the Black-Scoles model.

Year ended
December 31,
2008

Expected life of	3 - 3.5 years
Dividend yield	50%
Expected volatility	24% - 31%
Risk-free interest rate	4.3%-5.3%

For grants of Formula's employees – see Note 12

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NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

y. Derivatives and Hedging:

A portion of the Company's revenues and expenses is exposed to changes in foreign exchange rates. Depending on market conditions, foreign exchange risk also is managed through the use of derivative financial instruments and foreign currency debt. 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 in Euro, Japanese Yen and NIS exchange rate fluctuations.

ASC 815, "Derivatives and Hedging," requires companies to recognize all of their derivative instruments as either assets or liabilities in the statement of financial position 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.

Magic entered into forward contracts, these contracts serve to protect net income against the impact of the translation into U.S. dollars of certain foreign exchange-denominated transactions.

Matrix' and Sapiens' transactions did not qualify as hedging instruments under ASC 815. Gains or losses related to the transactions are recognized in current earnings during the period.

The notional amounts of outstanding foreign exchange forward contracts at December 31, 2010 are summarized below:

	Forward contracts	
	Buy	Sell
Euro	$ 1,003	$ 1,015
Japanese Yen	1,066	1,106
New Israeli Shekel	845	834
	$ 2,914	$ 2,955

At December 31, 2010, the effective portion of the Company's cash flow hedges before tax effect was $ 11, all of which is expected to be reclassified from accumulated other comprehensive income to revenues within the next 12 months.

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NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

z. Comprehensive income (loss):

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

aa. Fair value measurement:

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

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

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

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

The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The Company categorized each of its fair value measurements in one of these three levels of hierarchy.

Assets and liabilities measured at fair value on a recurring basis are comprised of marketable securities and foreign currency forward contracts (See Note 5).

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

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NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

ab. Discontinued operations:

Under ASC 205 "Presentation of Financial statements – Discontinued Operation", when a component of an entity, as defined in ASC 205, has been disposed of or is classified as held for sale, the results of its operations, including the gain or loss on the disposed component, should be classified as discontinued operations and the assets and liabilities of such component should be classified as assets and liabilities attributed to discontinued operations; that is, provided that the operations, assets and liabilities of the component have been eliminated from the Company's consolidated operations and the Company will no longer have any significant continuing involvement in the operations of the component.

ac. Reclassifications:

Certain comparative figures have been reclassified to conform to the current year presentation.

ad. Recently issued accounting pronouncements:

1. Adoption of New Accounting Standards during the period:

ASU 2010-06 - In January 2010, the FASB updated the "Fair Value Measurements Disclosures" codified in ASC 820. More specifically, this update require (a) an entity to disclose separately the amounts of significant transfers in and out of Levels 1 and 2 fair value measurements and to describe the reasons for the transfers; and (b) information about purchases, sales, issuances and settlements to be presented separately (i.e. present the activity on a gross basis rather than net) in the reconciliation for fair value measurements using significant unobservable inputs (Level 3 inputs). This update clarifies existing disclosure requirements for the level of disaggregation used for classes of assets and liabilities measured at fair value, and requires disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements using Level 2 and Level 3 inputs. As applicable to the Company, this update became effective as of the first quarter ended December 31, 2010, except for the gross presentation of the Level 3 roll forward information, which is required for annual reporting of December 31, 2010. The adoption of the new guidance did not have a material impact on the Company's consolidated financial statements.

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NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

2. Recently issued accounting Standards:

ASU 2009-13 - In October 2009, the FASB issued amendments to the accounting and disclosure for revenue recognition of multiple deliverable revenue arrangements codified in ASC 605-25. These amendments, modify the criteria for recognizing revenue in multiple element arrangements and require companies to develop a best estimate of the selling price to separate deliverables and allocate arrangement consideration using the relative selling price method. Additionally, the amendments eliminate the residual method for allocating arrangement considerations. These amendments establish a selling price hierarchy for determining the selling price of a deliverable, which is based on: a) vendor-specific objective evidence; b) third-party evidence; or c) estimates. In addition, this guidance significantly expands required disclosures related to a vendor's multiple-deliverable revenue arrangements.

ASU 2009-13 is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, with early adoption permitted. The Company has adopted the provisions of this guidance as of January 1, 2011. The Company does not believe that the adoption of the new guidance will have a material impact on its consolidated financial statements.

ASU 2010-28 - In December 2010, the EITF issued ASU 2010-28, When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts codified in ASC 350, "Intangibles - Goodwill and Other". Under ASC 350, testing for goodwill impairment is a two-step test, in which Step 1 compares the fair value of the reporting unit to its carrying amount. If the fair value of the reporting unit is less than its carrying value, Step 2 is completed to measure the amount of impairment, if any. This ASU modifies Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 if it appears more likely than not that a goodwill impairment exists.

In determining whether it is more likely than not that a goodwill impairment exists, an entity would consider whether there are any adverse qualitative factors indicating that an impairment may exist (e.g., a significant adverse change in the business climate). The Company does not believe that the adoption of the new guidance will have a material impact on its consolidated financial statements.

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NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

ASU 2010-29 - In December 2010, the EITF issued ASU 2010-29, "Disclosure of Supplementary Pro Forma Information for Business Combinations" codified in ASC 805, "Business Combinations". This ASU responds to diversity in practice about the interpretation of the pro forma disclosure requirements for business combinations. When a public entity's business combinations are material on an individual or aggregate basis, the notes to its financial statements must provide pro forma revenue and earnings of the combined entity as if the acquisition date(s) had occurred as of the beginning of the annual reporting period. The ASU clarifies that if comparative financial statements are presented, the pro forma disclosures for both periods presented (the year in which the acquisition occurred and the prior year) should be reported as if the acquisition had occurred as of the beginning of the comparable prior annual reporting period only and not as if it had occurred at the beginning of the current annual reporting period.

The ASU also expands the supplemental pro forma disclosure requirements to include a description of the nature and amount of any material non-recurring adjustments that are directly attributable to the business combination. The Company has determined not to early adopt the new guidance. The Company does not believe that the adoption of the new guidance will have a material impact on its consolidated financial statements.

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

a. In 2008, Matrix purchased all the shares of TACT Computers and Systems Ltd. ("TACT") for an aggregate consideration of $ 12,500. In 2009, Matrix paid to the sellers an additional and final consideration of approximately $ 6,400.

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

Current assets	9,615
Property and equipment	299
Goodwill	10,535
Customer related intangible asset	1,884
Total tangible and intangible assets acquired	22,333
Current liabilities	8,465
Other long-term liabilities	1,372
Total liabilities assumed	9,837
Net assets acquired	12,496
Cash paid	12,496

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

b. In October 2009, the Company completed the sale of 100% of its shares in its subsidiary, NextSource, for aggregate consideration of approximately $12,000, of which $ 8,000 was paid in cash and the remainder through the release of $ 4,000 bank deposits that were previously pledged in favor of banks to secure obligations of NextSource. The gain in the amount of approximately $ 4,300 was presented in the income statement as income from discontinued operation.

c. On January 17, 2010, Magic, through its U.S subsidiary Fusion Solution LLC, completed the acquisition of a consulting and staffing services business of a U.S-based IT services company, for a total consideration of $ 13,683, of which $ 8,625 was paid upon closing and the remaining $ 5,058 is to be paid over a three year period, of which, $ 506 is contingent upon the acquired business meeting revenue goals, and $ 4,552 in deferred payments. The Company believes that sufficient probability to meet these goals exists. The Company classified both the deferred payment and contingent considerations as a liability as of the date of the transaction.

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

The acquired business provides a comprehensive range of consulting and staffing services for the telecom, network communications and the information technology industry. The cash consideration of $ 8,625 was financed with the Company's own resources. The Company believes that the acquisition of this business activity will enable it to expand its presence in the U.S. market and leverage its relationships with top tier customers as well as take advantage of the synergies between its existing IT services and the acquired operation.

The acquisition was accounted for by the purchase method. The results of operations were included in the consolidated financial statements of the Company commencing January 17, 2010. The consideration for the acquisition was attributed to net assets on the basis of fair value of assets acquired and liabilities assumed, based on an appraisal performed by the management of Magic, which included a number of factors, including the assistance of independent appraisers.

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

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed, with reference to the acquisition as of January 17, 2010:

Working capital, including deferred tax liability	3,925
Fixed assets	54
Goodwill	4,831
Customer relationships	4,873
Total assets acquired	13,683
Total liabilities assumed	5,058
Net assets acquired	8,625

Identifiable intangible assets, including customer relationship were valued using a variation of the income approach known as the "Multi-Period Excess Earnings Approach". This method utilized a forecast of expected cash inflows, cash outflows and contributory charges for economic returns on tangible and intangible assets employed.

Below are certain unaudited pro forma combined statements of income data for the year ended December 31, 2009, as if the acquisition had occurred January 1, 2009, after giving effect to purchase accounting adjustments, including amortization of identifiable intangible assets, mainly customer relationships. This pro forma financial information is not necessarily indicative of the combined results that would have been attained had the acquisition taken place at the beginning of 2009, nor is it necessarily indicative of future results. Pro forma for 2010 was not provided since the activity was consolidated in the 2010 financial statements of income for 11.5 months, which was considered as fully consolidated for 2010.

	Year ended December 31, 2009 Unaudited
Total revenues	79,137
Net income attributable to Formula's shareholders	7,948