Chapter B of the Periodic Report
Directors' Report on the State of the Company's Affairs
<u>For the year ended December 31, 2007</u>

We respectfully present the Directors' Report on the state of affairs of "Bezeq" - The Israel Telecommunication Corp. Limited (hereinafter: "the Company") and the consolidated Group companies (the Company and the consolidated companies together are hereinafter referred to as "the Group"), for the year ended December 31, 2007 (hereinafter: "the Directors' Report").

The Group operates in four main areas which are reported as business segments in the Company's consolidated reports as set forth below:

1) **Fixed-line domestic communications**

2) **Cellular**

3) **International communications, internet services and NEP**

4) **Multi-channel television**

The Company has other areas of activity which are not material to the Group's operations, and these have been included in the Company's financial statements on December 31, 2007 as a business segment consisting mainly of customer call center services and investment in a venture capital fund.

In January 2007, BezeqCall merged with Bezeq International and they constitute in this statement one business segment: international communications, internet services and NEP.

The profit in the reporting year amounted to NIS 1,361 million compared to NIS 750 million in 2006. The increase in profit is mainly due to an increase in operating profit of NIS 1,565 million in 2006 to NIS 2,336 million in 2007. The increase in operating profit is mainly due to an increase in revenues in all the segments, with the exception of the domestic fixed-line communications segment, a decrease in salary expenses mainly from expenses in 2006 for allocation of options to employees of NIS 287 million, and a decrease in early retirement expenses of NIS 218 million compared to 2006. See below for further details.

1. Financial position

A. The financial statements are drafted in accordance with International Financial Reporting Standards (IFRS)

B. The Group's assets on December 31, 2007 amounted to NIS 15.16 billion, compared to NIS 17.55 billion on December 31, 2006. Of these, NIS 6.06 billion (40%) are property, plant and equipment, compared to NIS 6.49 billion (37%) on December 31, 2006.

Most of the decrease stems from the fixed-line domestic communications segment. There was a decline in total assets in this segment, not including investment in subsidiary companies, compared to the previous year, in the amount of NIS 2.90 billion, mainly due to the decline in the cash balances and the realization of financial assets held for trading which were used mainly for distribution of a dividend. In addition, there was a decrease in the depreciated cost of property, plant and equipment resulting from the difference between depreciation expenses and the investment made in the reporting year. The decrease in total assets was offset by an increase in the customer balance mainly due to a delay in issuing bills for customers.

In the cellular segment, assets increased from NIS 3.97 billion on December 31, 2006 to NIS 4.34 billion on December 31, 2007. Most of the increase was due to an increase in the cash balance. In addition, there was an increase in the customer balance due to an increase in sales in payment installments and the termination of credit card payments. On the other hand, there was a reduction in the tax asset due to realization of the asset recorded in the past for losses, and a decrease in the depreciated cost of property plant and equipment.

In the international communications, internet and NEP services segment, there was an increase in total assets compared to December 31, 2006, mainly due to an increase in the customer balance and advance expenses for users rights that were offset by a reduction in the cash balances used for early repayment of loans and tax advance payments.

In the multi-channel television segment, there was an increase in total assets compared to December 31, 2006, which was mainly due to an increase in broadcasting rights and an increase in the net investment balance in property, plant and equipment.

C. The shareholders' equity of the Company on December 31, 2007 amounted to NIS 4.54 billion, comprising 30% of the total balance sheet, compared to NIS 5.76 billion on December 31, 2006, which comprised 33% of the total balance sheet. The decrease in shareholder' equity is due to dividends paid in the amount of NIS 2.56 billion. The decrease was moderated by the Group’s net earnings.

D. Total Group debt on December 31, 2007 amounted to NIS 7.15 billion, compared to NIS 8.02 billion on December 31, 2006. The Group's debt to financial institutions and debenture holders on December 31, 2007 amounted to NIS 6.78 billion, compared to NIS 7.46 billion on December 31, 2006. The decrease is mainly due to payment of Eurobonds in the domestic fixed line communications segment in the amount of NIS 1.7 billion and payment of loans and debentures in the cellular segment. In addition, there was a decrease in loans in the multi-channel television segment and early payment of loans in the international communications, internet services and NEP segment.

The decrease was partially offset mainly by the sale of debentures to institutions in the domestic fixed-line communications segment in the amount of NIS 1.2 billion and issue of debentures in the multi-channel television segment in the amount of NIS 614 million.

The Company’s auditors have highlighted the financial position of DBS, as specified in Note 33(3) to the financial statements. As at the balance sheet date, DBS is not in compliance with the financial conditions set for it in the financing agreement. Subsequent to the balance sheet date DBS is in compliance with the financial conditions set for it in the financing agreement as at December 31, 2007, following a relief extended by the banks at that date. DBS applied to banks to update the conditions for 2008 in a way that would be compatible with the company budget. As at the approval date of the financial statements, the banks have approved DBS’ s application for an update of the conditions for 2008. The continuation of the company’s operations is also conditional on compliance with the conditions set for 2008 and/or with further reliefs it may received during the year. The management of DBS believes that the financial resources available to it will be sufficient for its operating needs in the coming year based on the forecasted cash flow approved the by Company’s board of directors.

E. The Group’s cash and other current investment balances on December 31, 2007 amounted to NIS 1.59 billion compared to NIS 3.59 billion on December 31, 2006. The decrease is mainly due to a decrease in the cash balance and realization of commercially held securities in the domestic fixed-line communications segment, which were used to pay a dividend in the amount of NIS 2.86 billion, and for payment of liabilities.

In the international communications, internet services and NEP segment, there was a decrease in the cash flow that was used for early payment of loans and advanced tax payments.
The decrease was partially offset by an increase in cash balances in the cellular segment, sale of debentures in the fixed-line domestic communications segment, debt raising in the multi-channel television segment and the cash flow from current operations in the principal segments of the Group's operations.

2. Results of operations

A. Principal results

Net earnings attributable to the shareholders of the Company for 2007 amounted to NIS 1,330 million, compared to net earnings of NIS 809 million in 2006. The rise in the net earnings is mainly due to an increase in operating income which increased by NIS 771 million (49%) in 2006.

Below are details of the changes in the results of the segments compared to 2006.

Segment	2007 Profit (NIS millions)	2006 Profit (NIS millions)
Fixed-line domestic communications	1,279	746
Cellular	804	692
International communications, internet services and NEP	203	119
Multi-channel television	50	8
Total	2,336	1,565

For details of the consolidated results see main data from the Group's Statement of Income in Section J below.

Basic earnings per share in 2007 amounted to NIS 0.51 per NIS 1.00 par value (diluted earnings per share amounted to NIS 0.50 per NIS 1.00 par value) compared to basic and diluted earnings per share of NIS 0.31 per NIS 1.00 par value in 2006.

B. **Revenue**

Group revenue in 2007 amounted to NIS 12.40 billion compared to NIS 12.23 billion in the previous year.

Revenues from fixed-line domestic communications decreased from NIS 5.80 billion in 2006 to NIS 5.71 billion in the reporting year (a decrease of 2%). Most of the decrease in the segment's revenues is attributable to a decrease in interconnect fees to the cellular networks due to tariff reductions. The decrease was accompanied by a parallel decrease in the segment's operating expenses. In addition, revenues decreased in the segment due to a decrease in tariffs in July 2006 and June 2007 and a reduction in call traffic. The decrease in revenues was moderated mainly by ongoing growth in revenues from high-speed internet service (ADSL) and by an increase in income from data communication services. The Company's auditors continue to highlight the growing competition and the impact of regulation.

Revenues from the cellular telephone segment increased from NIS 4.48 billion in 2006 to NIS 4.68 billion in the reporting year. The increase is due to an increase in revenue from sale of terminal equipment, mainly due to an increase in the quantity of handsets sold and upgraded. In addition, there was an increase in revenue from cellular services, following an increase in content revenue and an increase in the number of subscribers, which was mainly set off by price erosion.

Revenue in the international communications, internet and NEP services segment amounted to NIS 1.30 billion in the reporting period, and remained the same as in 2006. In this segment there was an increase in revenues from internet broadband service and from an increase in revenue from outgoing calls. In contrast, there was a decrease in operations relating to transfer of calls between communication operators around the world.

Revenues in the multi-channel television segment increased from NIS 1.36 million in 2006 to NIS 1.41 million in the reporting year, resulting from an increase in the number of subscribers and an increase in the average revenue per customer.

C. **Depreciation and amortization**

The Group's depreciation and amortization expenses decreased from NIS 1.86 billion in 2006, to NIS 1.77 billion in the reporting year, mainly due to a decrease in the depreciation expenses in the domestic fixed-line communication segment due to full depreciation of property plant and equipment and a decrease in investments in new.

D. **Salaries**

The Group's salary expenses in 2006 decreased from NIS 2.59 billion in 2006 to NIS 2.38 billion in the reporting year. The decrease in salary is mainly due to expenses resulting from allocation of options to employees in the amount of NIS 287 million, charged in 2006 to the domestic fixed-line communication segment. The decrease in expenses due to early retirement of employees in the domestic fixed-line communications sector was offset by salary increases in this segment and in the other segments in the Group.

E. **General and operating expenses**

The Group’s operating and general expenses in 2007 amounted to NIS 5.84 billion, compared to NIS 5.97 billion in 2006.

In the fixed-line domestic communications segment, operating and general expenses decreased from NIS 2.23 billion in 2006 to NIS 2.12 billion in the reporting year. The decrease is mainly due to a reduction in interconnect expenses to cellular operators, services and maintenance by subcontractors and building maintenance, which were offset by an increase in royalty expenses and general expenses, mainly due to an increase in interconnect expenses to fixed-line domestic communication operators.

In the cellular segment, general and operating expenses increased from NIS 2.73 billion in 2006 to NIS 2.79 billion in the reporting year, mainly due to an increase in costs of terminal equipment due to an increase in the quantity of handsets sold and an increase in access fees to telecom operators and content expenses as well as an increase in revenues from cellular services. In addition, there was an increase in advertising expenses mainly due to preparation for number portability.

In the international communications, internet services and NEP segment there was a decrease in general and operating expenses from NIS 836 million in 2006 to NIS 774 million in the reporting year. The decrease is mainly due to a reduction in operations relating to call transfers between communication operators around the world alongside revenues.

In the multi-channel television segment, general and operating expenses increased from NIS 889 million in 2006 to NIS 909 million in the reporting year, resulting from an increase in general expenses and advertising expenses, mainly due to costs resulting from the disruption of broadcasting services in September and compensation for customers. The increase was offset by a decline in content expenses in the use of satellite segments and a decrease in royalty expenses.

F. **Other operating expenses (income), net**

The Group’s other net operating expenses originated mainly from the domestic fixed-line communications segment. These expenses decreased from NIS 250 million in 2006 to NIS 79 million in the reporting year, mainly due to a decrease in expenses recorded for provision for severance pay in early retirement and a decrease in capital gain.

G. **Operating income**

The Group's operating income in 2007 amounted to NIS 2.34 billion, compared to NIS 1.57 billion in the previous year, an increase of NIS 771 million. The increase in operating income is due to the changes in the results of the segments described above in the revenue and expenses sections. These changes brought about an increase in operating income in all of the segments.

H. **Financing expenses - net**

The Group’s net financing expenses in 2007 amounted to NIS 309 million compared to NIS 338 million in 2006, a reduction of approximately NIS 29 million.

The Group's debt to financial institutes and debenture holders is mainly linked to the CPI and the financing expenses are affected by fluctuations in the index. In the reporting year there was a rise in the index compared to 2006 and revaluation of liabilities led to an increase in the Group's financing expenses.

In the domestic fixed line communications segment, there was an increase in net financing expenses compared to 2006. This is mainly due to a decrease in revenues in the capital market and realization of deposits and securities and a decrease in their return. In this segment there is an increase in expenses due to revaluation of CPI-linked liabilities and the foreign currency exchange rate, which was partially offset by hedging transactions. In addition, in 2006, there was a decrease in financing expenses for canceling the provision for termination of the disputes with the Ministry of Communications.

In the cellular segment, there was a decrease in financing expenses, mainly due to the reduction in liabilities and the decrease in the dollar exchange rate. The decrease was partially offset by the increase in expenses for revaluating CPI-linked liabilities as a result of a rise in the index.

In the multi-channel television segment net financing expenses in 2007 amounted to NIS 168 million compared to NIS 319 million in 2006. The increase in the CPI led to an increase in financing expenses due to the revaluation of CPI-linked liabilities. On the other hand, the fair value of the shareholders' loans was recalculated due to postponement of the expected payment dates. This change increased the financing income in the multi-channel television segment by NIS 213 million, and in the Group by NIS 96 million. This increase in the income of the Group was attributed to the minority interest in the subsidiary company, and accordingly, did not affect the profit attributed to the shareholders of the Company.

I. **Income tax**

The Group's tax expenses in 2007 amounted to NIS 672 million, representing approximately 33% of pre-tax profit, compared to NIS 488 million in 2006, representing 39% of pre-tax profit.
Most of the decrease in the rate of tax on profits before income tax is due to a 2% reduction in the tax rate and a decrease in losses in the multi-channel television segment for which deferred tax assets are not recorded.

J. **Main data from the Group's consolidated statements of income** (in NIS millions)

	Q1 2007	Q2 2007	Q3 2007	Q4 2007	2007	2006
Revenues	3,089	3,053	3,139	3,120	12,400	12,232
Costs and expenses (1)	2,432	2,482	2,543	2,607	10,064	10,667
Operating income	657	570	596	513	2,336	1,565
Financing expenses – net (2)	58	73	134	44	309	338
Earnings before Group's equity in earnings of associates	599	497	462	469	2,027	1,227
Equity in earnings of associates	1	1	1	3	6	11
Earnings before income tax	600	498	463	472	2,033	1,238
Income tax (3)	215	158	132	167	672	488
Earnings for the year	385	340	330	305	1,361	750
Attributable to:						
The Company's shareholders	399	361	255	315	1,330	809
Minority rights	(14)	(21)	75	(10)	31	(59)
Earnings for the year	385	340	330	305	1,361	750

Comparison of 2007 fourth quarter results with the results of the third quarter

Details of the material changes:

(1) The total costs and expenses increased by NIS 64 million compared with the prior quarter. The increase is mainly due to an increase in operating expenses in the cellular segment, as a result of costs incurred by the preparation for number portability. In the domestic fixed-line communications segment, there was an increase in the fourth quarter as a result of updating the liabilities for early retirement and other actuary liabilities, which were offset by an increase in capital gain.

(2) Net financing expenses decreased by NIS 90 million compared to the prior quarter. The financing expenses in the prior quarter were mainly affected by an increase in the CPI to which most of the Group's liabilities are linked, by a decrease in return on investments and by income recorded in the prior quarter in connection with the change in terms for the shareholders' loans in the multi-channel television segment amounting to NIS 96 million.

(3) The increase in the effective tax rate in the fourth quarter is due to the increase in the losses of DBS for which the Company does not record deferred tax assets.

3. Liquidity and sources of financing

Consolidated cash flows generated by operating activities in 2007 amounted to NIS 3.07 billion, compared to NIS 3.79 billion in 2006, a decrease of NIS 719 million. The decrease in cash flows generated by operating activities is mainly due to revenues and expenses not involving cash flows resulting from changes in the assets and liabilities items, including an increase in the customer balance and payments for early retirement. The decrease was offset by the increase in earnings.

Cash flows generated by operating activities are one of the sources of financing of the Group's investments, which during the reporting year included NIS 973 million invested in development of communications infrastructures, compared to investments amounting to NIS 953 million in 2006. During the reporting year, the Group realized investments in net financial assets of NIS 705 million, compared to net investments of NIS 1.54 billion in 2006.

In the reporting year, the Group repaid debts and paid interest of NIS 3,193 million, of which NIS 1,927 million was on account of debentures, NIS 840 million in loans, NIS 37 million in short-term credit, and NIS 389 million in interest payments. The Group raised new debt amounting to NIS 1,864 million by taking loans in the amount of NIS 50 million and issuing debentures in the amount of NIS 1,814 million, compared to payment of net debt and interest payments in the amount of NIS 2,058 million in 2006. The Company has a cash flow from net considerations for removal of derivative financial instruments, serving to hedge loans, in the amount of NIS 77 million in 2007 compared to a net payment of NIS 76 million in 2006.

In the reporting year, cash dividends in the amount of NIS 2.86 billion were paid, compared to NIS 1.6 billion in 2006.

The monthly average short-term credit balance from banks in 2007 amounted to NIS 88 million. The monthly average of long-term liabilities to financial institutions and debenture holders in 2007 amounted to NIS 7,305 million

The working capital on December 31, 2007 was negative, and amounted to NIS 676 million, compared to negative operating capital on December 31, 2006 that amounted to NIS 1,214 million, a decrease of NIS 538 million in deficit. The increase in the working capital is due to an increase in working capital in all the segments in which the Group operates with the exception of the domestic fixed line communications segment.

In this segment there was an increase in the working capital deficit compared to the previous year in the amount of NIS 573 million. The increase is mainly due to a decrease in cash flow and cash value and realization of commercially held financial assets. On the other hand, there was a decrease in current liabilities mainly due to a decrease in current maturities of loans and debentures, obligation to pay a dividend that was recorded last year and a decrease in current provisions related to benefits for employees and others. The working capital was used mainly to pay the dividend and pay off liabilities.

4. Considerations of the board of directors in deciding on or recommending payments to each of the five highest salary recipients among its officers

The salary of the five highest-salaried officers was approved by the authorized entities of the Company, as relevant. The board of directors agrees that the salary levels of the officers do not deviate from the convention in similar corporations in the country.

5. Group involvement in the community and donations

The Group is active in the community through its involvement in social institutions and organizations such as the education system in underprivileged areas and the confrontation line. Its contributions in the reporting year amounted to NIS 1.8 million. In addition, Group employees volunteer in additional and diverse community involvement activities.

During the reporting year the Company donated NIS 1.3 million. The principal recipients are listed below:

In the project "Children and Parents Study Computer and Internet", which has been ongoing for some six years, the Company's employees voluntarily mentor underprivileged parents and children on selected subjects in computers and the internet.

In the “Summer for the Community” project, which the Company has run for four years now, employees’ children worked in medical institutions and community centers during the summer. The cost of the project to the Company was NIS 940,000.

The Company’s employees and pensioners established the Milk, Bread and Eggs association. The association works in cooperation with the local authorities to locate disadvantaged families in order to supply them with basic food products.

Pelephone has no binding policy regarding donations and its management discusses each case on an individual basis. During the reporting year, Pelephone donated NIS 30,000 to various associations.

Bezeq International is involved in ongoing operations on behalf of underprivileged communities in Petach Tikva, it adopted “lone” soldiers and a combat division and participated in projects for children with special needs. During the reporting year, Bezeq International's expenses amounted to NIS 500,000.

6. Exposure to and management of market risks

Responsibility for management of the Company’s market risks

The Deputy CEO and CFO is responsible for management of the Company's market risks. In the reporting year, Ran Oz filled this position and from February 15, 2008 Alan Gelman fills this position. For details of their education and experience, see Section 13 (C) in Chapter D of the Periodic Report.

Market risks and the Company's risk management policy

The Company is exposed to market risks as a result of changes in interest rates, exchange rates, inflation, the prices of raw materials and equipment, and the prices of securities.

Interest – The Company’s debentures bear fixed interest and therefore change in the interest rate will affect the fair value and not their book value.

The Company has investments in negotiable bonds that are shown in the Company's books at their market value. This market value is influenced by changes in the interest rates in the economy.

At the date of this report, the Company does not hedge against the aforementioned exposures. It is not inconceivable, however, that it will do so under future market circumstances. Furthermore, the Company takes into account such influences when considering the types of loans it takes and when managing its investment portfolio.

Exchange rates – A change in the shekel exchange rate constitutes economic exposure in that it can affect the Company's future earnings and cash flows, mainly the repayment of currency-linked liabilities and payments for the currency-linked purchase of equipment and raw materials.

In order to minimize this exposure, the board of directors decided that the Company should partially or fully hedge the accounting exposure deriving from all the balances recorded in the balance sheet. In the event of partial hedging, the unhedged exposure would not exceed an amount equivalent to $150 million, of which not more than the equivalent of $50 million would relate to currencies other than the US dollar. In addition, the Company is able to implement additional hedging transactions from time to time against exposure to expected transactions during one year of operation, this being limited to a total volume not exceeding the equivalent of $100 million – of which not more than the equivalent of $30 million would relate to currencies other than the U.S. dollar The reduction of exposure during the reporting year was accomplished by means of forward transactions (or sale according to exposure direction) in currencies hedged against shekels or against CPI-linked shekels. The time frame of the forward transactions is equal to or shorter than the time frame of the hedged exposure.

The Company recorded no significant costs in making hedging transactions against the exchange rate, since they were made as forward transactions. The financial statements include financing revenues of approximately NIS 106 million from these hedging transactions.

Inflation – The rate of inflation affects the operating income and expenses of the Company during the year.

The Company's tariff updating mechanism as set forth in the Regulations allows tariffs to be updated according to the rise in the CPI (less a fixed efficiency factor) once a year. As a result, the annual rate of inflation and its distribution over the year can have a material influence on the erosion of the Company's tariffs and on its revenues. On the other hand, the influence of the rate of inflation on the Company's expenses is reduced, since some of these expenses have direct or indirect linkage mechanisms.

In addition, the Company invests a considerable part of its cash balances in unlinked shekel value deposits, and these investments are exposed to changes in their real yield caused by a change in the rate of inflation.

The Company has a surplus of liabilities over CPI-linked assets. As part of its policy of minimizing exposure, the Company has made hedging transactions against the CPI so as to reduce this risk.

The Company recorded no significant costs in making hedging transactions against the index, since they were made as forward transactions. The financial statements include financing revenues of NIS 56 million from these hedging transactions.

Prices of raw materials and equipment – Cash flows generated by the Company's operations are used partially for investment in equipment. The prices of equipment are affected by the indices to which they are linked, including sectoral price indices, exchange rates and global prices. The Company does not hedge against this exposure.

Prices of securities – The Company invests some of its financial balances in securities. The investment policy was determined by the Company's board of directors. With the aim of preventing fluctuations in the portfolio's yield, the board of directors set investment principles whereby most of the investment will be in bonds and shekel deposits. The types of investment and their proportional part in the investment portfolio were determined according to criteria based on linkage, rating, redemption date, liquidity and risk. In addition, a separation between government and non-government bonds was defined. A monetary ceiling was also determined for the various types of investments.

Risks and risk management in the consolidated companies - The persons responsible for management of the market risks in the principal consolidated companies are the CFOs of those companies and at Pelephone, the company treasurer as well. The consolidated companies make hedging transactions in accordance with the decisions of their boards of directors and under their supervision.

The consolidated financial statements include financing income of NIS 141 million from hedging transactions in the reporting year.

Linkage based report - Note 30 to the Financial Statements includes information on the linkage terms of the financial assets.

There were substantial changes during the year in the domestic fixed-line communications segment. These changes led to a change in the linkage conditions of the monetary balances: a reduction in the euro-linked liabilities due to payment of debentures (Eurobonds) in the amount of NIS 1.7 billion and sale of index-linked debentures to institutions in the amount of NIS 1.2 billion.

<u>Below a sensitivity analysis of the Group's assets and liabilities to changes in foreign currency exchange rates, the CPI, interest and market prices of securities</u>

Sensitivity analysis 2007 (in NIS millions)

Sensitivity to changes in the dollar/NIS exchange rate - 2007

	Profit (loss) from changes		Fair value	Profit (loss) from changes	
	10%	5%	At a dollar rate of 3.846	-5%	-10%
Cash	8	4	83	(4)	(8)
Trade receivables	6	3	58	(3)	(6)
Other receivables	0.1	0.1	1	(0.1)	(0.1)
Other investments, including derivatives	4	2	35	(2)	(4)
Long-term trade receivables	2	1	25	(1)	(2)
Accounts payable	(31)	(16)	(313)	16	31
Other liabilities	(0.1)	(0.1)	(1)	0.1	0.1
Firm commitments – space sections	(34)	(17)	(343)	17	34
Firm commitments - suppliers	(43)	(22)	(435)	22	43
Firm commitments - rent	(4)	(2)	(45)	2	4
Firm commitments – vehicle leasing	(2)	(1)	(19)	1	2
Guarantees	8	4	85	(4)	(8)
Hedging instruments not recognized for accounting					
Dollar/shekel forward transactions	35	18	(11)	(18)	(35)
Total	**(51)**	**(26)**	**(880)**	**26**	**51**

The table shows the items sensitive to fluctuations in the dollar/shekel exchange rate. The sensitivity of the items in the balance sheet was tested, as were off-balance sheet items. The firm commitments are off-balance sheet commitments, denominated and/or linked to the dollar and therefore sensitive to changes in the exchange rate.

Sensitivity to changes in the euro/NIS exchange rate - 2007

	Profit (loss) from changes		Fair value	Profit (loss) from changes	
	10%	5%	At a euro rate of 5.6592	-5%	-10%
Cash	0.3	0.2	3	(0.2)	(0.3)
Other investments, including derivatives	6	3	56	(3)	(6)
Loans and debentures	(3)	(2)	(31)	2	3
Accounts payable	(1)	(0.4)	(8)	0.4	1
Current liabilities	(0.1)	-	(1)	-	0.1
Hedging instruments not recognized for accounting					
Total	**2.2**	**0.8**	**19**	**(0.8)**	**(2.2)**

The table shows the items sensitive to changes in the euro/shekel exchange rate.

Sensitivity to changes in the sterling/NIS exchange rate - 2007

	Profit (loss) from changes		Fair value	Profit (loss) from changes	
	10%	5%	At a sterling rate of 7.7105	-5%	-10%
Investments in securities	0.1	-	1	-	(0.1)
Total	**0.1**	**-**	**1**	**-**	**(0.1)**

The Company has securities exposed to the pound sterling. The fair value of the securities was calculated by multiplying the market price on December 31, 2007 with the nominal value held by the Company at that time.

Sensitivity to changes in the CPI – 2007

	Profit (loss) from changes		Fair value	Profit (loss) from changes	
	10%	5%		-5%	-10%
Trade receivables	-	-	15	-	-
Investments and debit balances	-	-	11	-	-
Long-term receivables	-	-	24	-	-
Other liabilities and provisions	(0.3)	(0.1)	(131)	0.1	(0.3)
Firm commitments – vehicle leasing	(0.1)	(0.1)	(52)	0.1	(0.1)
Firm commitments - rent	(1)	(1)	(579)	1	(1)
Firm commitments - suppliers	(0.2)	(0.1)	(105)	0.1	(0.2)
Guarantees	-	-	(33)	-	-
Debentures issued to financial institutes and others	(2)	(1)	(776)	1	(2)
Debentures issued to financial institutes and others	(2)	(1)	(928)	1	(2)
Debentures issued to financial institutes and others	(1)	(1)	(650)	1	(1)
Bank loans	(1)	(0.5)	(461)	0.5	(1)
Loans from others	(0.3)	(0.1)	(137)	0.1	(0.3)
Loans provided by the minority in a subsidiary	(1)	(0.4)	(375)	0.4	(1)
Hedging instruments not recognized for accounting					
Hedging transactions against the index	7	4	53	(4)	(7)
Total	**(1.9)**	**(1.3)**	**(4,124)**	**1.3**	**(15.9)**

A sensitivity analysis of 5% and 10% (up and down) was conducted on an inflation assessment of 2% per year, based on the Inflation Target Center at the Bank of Israel. The Group has debentures and loans from banks and other sources, which are linked to the index.

Sensitivity to changes in real shekel interest rates - 2007

	Profit (loss) from changes		Fair value	Profit (loss) from changes	
	10%	5%		-5%	-10%
Debentures issued to the public - Series 4	7	4	(1,340)	(4)	(7)
Debentures issued to the public - Series 5	36	18	(1,706)	(19)	(37)
Debentures issued to financial institutes and others	5	2	(776)	(2)	(5)
Debentures issued to financial institutes and others	12	6	(928)	(6)	(12)
Debentures issued to financial institutes and others	24	12	(650)	(13)	(26)
Bank loans	4	2	(461)	(2)	(4)
Loans from others	8	4	(137)	(4)	(8)
Total	**96**	**48**	**(5,998)**	**(50)**	**(99)**

The Group's companies have index-linked debentures at fixed interest. The debentures are sensitive to changes in the real shekel interest rate.
The fair value of non-negotiable debentures was calculated by discounting the future cash flows. The Company also has index-linked loans affected by the change in the real shekel interest rate. Their fair value is calculated by discounting the future cash flows.

Sensitivity to changes in nominal NIS interest rates - 2007

	Profit (loss) from changes			Fair value	Profit (loss) from changes		
	12%	10%	5%		-5%	-10%	-12%
Investments and debit balances		(1)	(0.4)	150	0.4	1	
Long-term trade receivables		(2)	(1)	176	1	2	
Long-term trade receivables		(6)	(3)	936	3	7	
Hedging instruments not recognized for accounting							
Dollar/shekel forward transactions	1	0.5	0.2	(11)	(0.2)	(0.5)	(1)
Total	**1**	**(8.5)**	**(4.2)**	**1,251**	**4.2**	**9.5**	**(1)**

The sensitivity analysis of the shekel interest rate in dollar/shekel forward transactions includes another scenario (12% up and 12% down), which examines the most extreme daily change that occurred in the last ten years (a daily change of 12% in December 2001).

Sensitivity to changes in shekel dollar interest rates - 2007

	Profit (loss) from changes			Fair value	Profit (loss) from changes		
	15%	10%	5%		-5%	-10%	-15%
Firm commitments – space sections	7	5	2	(343)	(2)	(5)	(7)
Hedging instruments not recognized for accounting							
Dollar/shekel forward transactions	(1)	(0.4)	(0.2)	(11)	0.2	0.4	1
Total	**6**	**4.6**	**1.8**	**(354)**	**(1.8)**	**(4.6)**	**(6)**

The sensitivity analysis of the dollar interest rate includes another scenario (15% up and 15% down), which examines the most extreme daily change that occurred in the last ten years (a daily change of 15% in June 2003).
The increase in the dollar interest lowers the fair value of forward transactions by reducing the interest difference.

Sensitivity to changes in prices of negotiable shekel securities - 2007

	Profit (loss) from changes		Fair value	Profit (loss) from changes	
	2.50%	1.25%		-1.25%	-2.50%
Investment in securities	2	1	78	(1)	(2)
Total	**2**	**1**	**78**	**(1)**	**(2)**

The Company has unlinked shekel debentures. The sensitivity analysis of the shekel debentures (unlinked) was made at values of 1.25% and 2.5%, based on a historical examination of the maximum change in prices of shekel debentures.

Sensitivity to changes in prices of index-linked negotiable securities - 2007

	Profit (loss) from changes		Fair value	Profit (loss) from changes	
	2%	1%		-1%	-2%
Investment in securities	3	1	149	(1)	(3)
Total	**3**	**1**	**149**	**(1)**	**(3)**

The sensitivity analysis of the debentures was made at values of 1% and 2%, based on a historical examination of the maximum change in the prices of index-linked and foreign currency-linked debentures.

Sensitivity to changes in prices of dollar-linked debentures - 2007

	Profit (loss) from changes		Fair value	Profit (loss) from changes	
	2%	1%		-1%	-2%
Investment in securities	0.1	-	4	-	(0.1)
Total	**0.1**	**-**	**4**	**-**	**(0.1)**

The Company has both government and non-government (company) debentures linked to the dollar.

Sensitivity to changes in prices of negotiable securities - 2007

	Profit (loss) from changes		Fair value	Profit (loss) from changes	
	10%	5%		-5%	-10%
Shares	3	2	34	(2)	(3)
Convertible debentures (shares)	0.1	0.1	1	(0.1)	(0.1)
Other	0.2	0.1	2	(0.1)	(0.2)
Total	3.3	2.2	37	(2.2)	(3.3)

	Profit (loss) from changes			Fair value	Profit (loss) from changes		
	118%	10%	5%		-5%	-10%	-80%
Shares	5	0.4	0.2	4	(0.2)	(0.4)	(3)
Total	5	0.4	0.2	4	(0.2)	(0.4)	(3)

The sensitivity analysis of the share includes another scenario (118% up and 80% down), which examines the most extreme daily change that occurred in the last five years (a maximum daily change of 118% on March 6, 2003 and a minimum daily change of 80% on August 13, 2002.

Sensitivity analysis 2006 (in NIS millions)

Sensitivity to changes in the dollar/shekel exchange rate - 2006

	Profit (loss) from changes		Fair value	Profit (loss) from changes	
	10%	5%	At a dollar rate of 4.225	-5%	-10%
Cash	5	2	48	(2)	(5)
Trade receivables	6	3	60	(3)	(6)
Other investments	13	7	131	(7)	(13)
Suppliers and service providers	(38)	(19)	(381)	19	38
Firm commitments	(56)	(28)	(556)	28	56
Firm commitments – space sections	(42)	(21)	(417)	21	42
Guarantees	(9)	(5)	(93)	5	9
Hedging instruments not recognized for accounting					
Dollar/shekel forward transactions	23	12	(7)	(12)	(23)
Total	**(98)**	**(49)**	**(1,215)**	**49**	**98**

The table shows the items sensitive to changes in the dollar/shekel exchange rate. The sensitivity of the items in the balance sheet was tested, as were off-balance sheet items. The firm commitments are off balance-sheet commitments, denominated and/or linked to the dollar and therefore sensitive to changes in the exchange rate.

Sensitivity to fluctuations in the euro/NIS exchange rate – 2006

	Profit (loss) from changes		Fair value	Profit (loss) from changes	
	10%	**5%**	**At a euro rate of 5.5643**	**-5%**	**-10%**
Cash	0.5	0.2	5	(0.2)	(0.5)
Trade receivables	0.7	0.4	7	(0.4)	(0.7)
Other investments	3	1	27	(1)	(3)
Deposit investments	4	2	39	(2)	(4)
Eurobonds	(169)	(85)	(1,691)	85	169
Debentures	(3)	(2)	(33)	2	3
Accounts payable	(2)	(1)	(20)	1	2
Hedging instruments not recognized for accounting					
Euro/shekel forward transactions	157	79	(31)	(79)	(157)
Total	**(8.8)**	**(5.4)**	**(1,697)**	**5.4**	**8.8**

The table shows the items sensitive to changes in the euro/shekel exchange rate. The forward transactions for purchase of euro against shekels are for up to seven months. These transactions serve as hedges against the euro denominated-linked debt.

Sensitivity to changes in the CPI - 2006

	Profit (loss) from changes		Fair value	Profit (loss) from changes	
	10%	**5%**		**-5%**	**-10%**
Trade receivables	-	-	12	-	-
Other receivables	-	-	15	-	-
Other debits	0.1	-	61	-	(0.1)
Other liabilities and provisions	(0.4)	(0.2)	(199)	0.2	0.4
Firm commitments - leasing	(0.4)	(0.2)	(214)	0.2	0.4
Firm commitments - orders	(0.4)	(0.2)	(220)	0.2	0.4
Firm commitments - rent	(1)	(0.6)	(548)	0.6	1
Guarantees	-	-	(33)	-	-
Non-negotiable debentures	(4)	(2)	(1,829)	2	4
Bank loans	(3)	(1)	(1,316)	1	3
Loans from others	(0.3)	(0.1)	(135)	0.1	0.3
Loans provided by the minority	(1)	(0.6)	(564)	0.6	1
Hedging instruments not recognized for accounting					
Index/shekel forward transactions	3	1	(14)	(1)	(3)
Total	**(7.4)**	**(3.9)**	**(4,984)**	**3.9**	**7.4**

A sensitivity analysis of 5% and 10% (up and down) was conducted on an inflation assessment of 2% per year, based on the Inflation Target Center at the Bank of Israel.
The Group has debentures and loans from banks and other sources, which are linked to the CPI.

Sensitivity to changes in real shekel interest rates 2006

	Profit (loss) from changes		Fair value	Profit (loss) from changes	
	10%	**5%**		**-5%**	**-10%**
Non-negotiable debentures	19	10	(1,829)	(10)	(19)
Debentures issued to the public - Series 4	14	7	(1,279)	(7)	(14)
Debentures issued to the public - Series 5	12	6	(483)	(6)	(12)
Bank loans	4	2	(1,316)	(2)	(4)
Loans from others	7	4	(135)	(5)	(9)
Total	**56**	**29**	**(5,042)**	**(30)**	**(58)**

The companies of the Group have non-negotiable debt and index-linked bank loans to institutional entities. The table tests the sensitivity of the debt to changes in the real interest rate.

Sensitivity to changes in shekel interest rates - 2006

	12%	10%	5%	Fair value	-5%	-10%	-12%
Dollar/shekel forward transactions	0.6	0.5	0.3	(7)	(0.3)	(0.5)	(0.6)
Euro/shekel forward transactions	4	3	2	(31)	(2)	(3)	(4)
Investments in deposit		(0.9)	(0.5)	183	0.5	0.9	
Long-term trade receivables	(7)	(6)	(3)	794	3	6	7
Total	(2.4)	(3.4)	(1.2)	939	1.2	3.4	2.4

The sensitivity analysis of the shekel interest rate includes another scenario (12% up and 12% down), which examines the most extreme daily change that occurred in the last ten years (a daily change of 12% in December 2001).

Sensitivity to changes in dollar interest rates - 2006

	15%	10%	5%	Fair value	-5%	-10%	-15%
Dollar/shekel forward transactions	(0.8)	(0.5)	(0.2)	(7)	0.3	0.5	0.8

The sensitivity analysis of the dollar interest rate includes another scenario (15% up and 15% down), which examines the most extreme daily change that occurred in the last ten years (a daily change of 15% in June 2003).
The fair value of the forward transactions was calculated by discounting the difference between the price set on the date of measurement for forward transactions for the same future date, and the price in the transaction signed by the Company, multiplied by the nominal value of the transaction and discounted from the date of clearing the transaction to the measurement date.
The interests rates used to calculate the fair value are the risk-free rates for the relevant year (shekel interest and dollar interest).

Sensitivity to changes in euro interest rates - 2006

	10%	5%	Fair value	-5%	-10%
Euro/shekel forward transactions	(3)	(2)	(31)	1	3

Sensitivity to changes in securities rates 2006

	Profit (loss) from changes			Fair value	Profit (loss) from changes		
	12%	**10%**	**5%**		**-5%**	**-10%**	**-12%**
Shares	4	4	2	36	(2)	(4)	(4)

	Profit (loss) from changes			Fair value	Profit (loss) from changes		
	118%	10%	5%		-5%	-10%	-80%
Share	9	0.8	0.4	8	(0.4)	(0.8)	(6)

The sensitivity analysis of the share portfolio includes another scenario (12% up and 12% down), which examines the most extreme situation (a daily change at that level would result in suspension of trading in the security).

Sensitivity to changes in securities rates 2006

	Profit (loss) from changes		Fair value	Profit (loss) from changes	
	2%	**1%**		**-1%**	**-2%**
Index-linked debentures	10	5	479	(5)	(10)
Foreign currency	2	0.9	90	(0.9)	(2)
Total	12	5.9	**569**	(5.9)	12

The sensitivity analysis of the debentures was made at values of 1% and 2%, based on a historical examination of the maximum change in prices of index-linked and foreign currency-linked debentures.

Sensitivity to changes in securities rates 2006

	Profit (loss) from changes		Fair value	Profit (loss) from changes	
	2.50%	**1.25%**		**-1.25%**	**-2.50%**
Unlinked shekel debentures	7	4	289	(4)	(7)

The sensitivity analysis of the shekel debentures (unlinked) was made at values of 1.25% and 2.5%, based on a historical examination of the maximum change in prices of shekel debentures.

7. Directors with accounting and financial expertise

A. The Company's Board of Directors determined that the minimum number of directors who have accounting and financial expertise, as required by the provisions of the Companies Law, is one (and together with the external directors – two). The Board of Directors believes that this number will enable it to fulfill the duties imposed upon it by law and by the documents of association, including review of the financial condition of the Company and preparing and approving the financial statements, taking into consideration the volume and complexity of its operations

B. Serving directors in the Company who have the above skills are Shlomo Rodav (chairman), Zehavit Cohen, Menachem Inbar, Yoav Rubenstein, David Gilboa, Eyal Yaniv (external director) and Yitzhak Edelman (external director). For information about their relevant education and experience, see Section 12 in Chapter D of the Periodic Report.

8. Disclosure regarding an internal auditor in a reporting corporation

8.1 The Company's internal auditor

a. Name: Malka Dror

b. Date of commencement of office: August 14, 2006 (appointed as substitute), and from June 28, 2007, permanent appointment

c. The internal auditor complies with the conditions set forth in Article 3(A) of the Internal Audit Law. Qualifications: BA in Economics (Hebrew University); CISA (Certified Information Systems Auditor) – USA)

Internal auditing experience: 23 years in various internal auditing positions

d. The internal auditor complies with the provisions of Article 8 of the Internal Audit Law and Article 146(B) of the Companies Law.

e. Mrs. Dror (who has been employed in the Company since 1985) was allocated, before her appointment to the position of internal auditor, options to purchase Company shares as part of two allocations of options to all the employees in the Company: 44,287 options to purchase the Company's shares held by the State as part of an option outline for Company employees for 2005 on November 15, 2005, within the framework of the State's obligations in connection with the Company's privatization process (at the report date the auditor exercised and sold 14,763 of these options), and 32,856 options of the Company to purchase its shares as part of the option outline for Company employees on February 22, 2007 in accordance with the Company's obligation under the collective agreement from 5 December 2006. In addition, pursuant to a resolution adopted by the board of directors on March 10, 2008, the internal auditor will be allocated 100,000 options as part of allocation of options to middle-managers in the Company according to an outline to be published in the next few days. The Company believes that these holdings do not affect the quality of the internal auditor's work.

f. The Internal Auditor has no material business connections or other material connections with the Corporation or with a body affiliated to it.

g. Employment basis: The internal auditor is a Company employee.

8.2 Method of appointment

Audit committee discussions at its meetings on June 17, 2007 and June 21, 2007.

The committee recommended appointing Malka Dror as the Company's internal auditor. Later on, the committee recommended appointing her to the Company management and granting her salary conditions and accompanying rights that are within the range of those granted to VPs in the Company. The board of directors approved the appointment on June 28, 2007.

Summary of the reasons for approving the appointment

The board of directors approved the appointment of Malka Dror, who served as acting internal auditor, as internal auditor following the recommendation of the audit committee, due to her qualifications and professional experience.

Duties, authority and tasks of the internal auditor

The authority and responsibility of the Company's internal auditor are determined in the regulation "Internal Auditor of the Company". The regulation was revised and approved by the board's audit committee on December 27, 2007.

Duties of the internal auditor according to the Company's internal audit regulation

a. To examine the propriety of the Company's operations, officers and senior employees from the following aspects: compliance with applicable laws and regulations and proper business practices; principles of sound management, thrift, efficiency, and integrity, to verify that they were carried out lawfully by a qualified person, that they were accepted according to business considerations and that they contribute to the achievement of the Company's defined goals; compatibility with the policy and decisions made by the board of directors and Company management.

b. To examine the reliability and quality of the financial and operational information

c. To inspect the cash management, the Company's liabilities and arrangements to safeguard the Company's assets and their entirety, and their operative efficiency and use

d. To investigate whether the Company's decisions, including those made by the board of directors and its committees, were made in accordance with proper procedures.

e. To audit the Company's computerized information systems and information security system

f. As required, to audit material transactions in the Company, including the procedures for their approval. In this matter, "material transactions" include the purchase or sale of material operations, transactions as set forth in Article 270 of the Companies Law, and irregular transactions as defined in the Companies Law.

g. To examine the propriety and effectiveness of the Company's procedures for entering into commitments.

h. To recommend the definition or amendment of procedures on material issues, which the internal auditor believes to require determination or amendment.

i. To expose shortcomings in the Company’s business practices, identify the reasons for their existence, and note the causes responsible for them, and to make proposals for correcting the shortcomings and preventing their recurrence

j. To re-audit in order to monitor the correction of the shortcomings and implementation of the decisions made following the audit report.

Authorities of the Company's internal auditor according to the Company’s internal audit regulation

a. The Company's internal auditor may demand and receive any information, explanation and document required at her discretion for the performance of her duty, and every Company employee is obliged to furnish any document or information at the Company's internal auditor's first request. Every Company employee requested to provide information to the auditor is required to comply with the request at the time and in the manner determined thereat.

b. The manager and employees of the audited department will allow the internal auditor and audit staff to perform the audit and will assist them with any request.

c. For performance of her duty, the internal auditor shall be granted access to any ordinary or computer databank, to any database and to any automated or non-automated data processing work program in the Company.

d. The internal auditor may enter and inspect any of the Company's assets.

e. The above authorities are also granted to audit department staff and to any person acting on behalf of the internal auditor.

f. Participation in meetings of the management, board of directors and its committees:

1. The internal auditor will be invited to all audit committee meetings.
2. The internal auditor will be invited to all meetings of the board of directors and its committees and will have the right to participate in them, at her discretion.
3. The internal auditor will receive the material attached to the invitation to the meetings of the board of directors and its committees.
4. The internal auditor will be invited to all management committee meetings.
5. Notwithstanding the aforesaid in subclause (2) and (3), the chairman of the board will have the right to decide, at his discretion, that the internal auditor will not be invited to some of the board and committee meetings (that are not audit committee meetings) that have particularly sensitive agendas, and/or the internal auditor will not receive the background material for the discussions of these issues. The board chairman will inform the internal auditor and audit committee chairman of his decision before the meeting.
6. The internal auditor will receive, routinely, the minutes of all the meetings of the board of directors and its committees (including minutes of the discussions on subjects in which the internal auditor did not participate as specified in subclause (5) above.

g. The internal auditor may ask the chairman of the audit committee to convene the committee to discuss a subject defined in his request; the chairman of the audit committee will convene the committee within a reasonable time from the date of the request, should he deem fit.

h. The internal auditor may, with the approval of the audit committee chairman, examine a complaint received by the auditing department as part of the auditing work.

i. At least once a year, the Company's internal auditor will hold a work meeting with each of the internal auditors of the Company’s subsidiaries to discuss the subsidiary company’s audit plan and its implementation.

j. The Company's internal auditor will be authorized to ask for copies of the subsidiary companies' audit reports, as required according to her consideration.

8.3 Organizational officer responsible for the internal auditor

According to a resolution of the Company's board of directors, the chairman of the board is the organizational officer responsible for the internal auditor.

8.4 Work program

a. The work program is annual.

b. **Considerations in determining the internal audit work program**

The guiding principle behind the annual work program for the internal audit is the risk inherent in the Company's processes and operations. To assess the risks, the audit prepares a 'control risk survey' of the Company at least once every three years. As part of this survey, the audit examines, in cooperation with the Company's senior management, the material exposures and risks in the Company's operations and the control environment existing for management of these risks. The survey findings are used to compile the topics for the annual and multi-year work program.

The considerations taken into account in the compilation of the work program are as follows: reasonable coverage of all the Company's areas of business according to exposure to material risk (finance; sales and marketing; personnel and payroll, investments, mergers and acquisitions; safety and security; information technology – IT; economics and logistics; engineering and planning).

c. **Entities involved in determining the work plan**

Preparation of follow-up checks – at the request of the board's audit committee or the recommendation of the internal auditor. In addition to the subjects determined in the annual work program, the audit prepares 'special examinations. These examinations are not included in the work program, and are prepared at the request of the board chairman, audit committee chairman or the CEO.

d. **The entity accepting and approving the work plan**

The board's audit committee

e. **The auditor's consideration to deviate from the work plan**

The auditor may propose subjects at her discretion or at the request of the CEO. In any event the approval of the audit committee chairman is required

f. During the reporting year the auditor did not examine any material transactions

8.5 The audit's response to corporations comprising a material holding

The work plan of the auditing department does not include audit in corporations representing material holdings In all the corporations representing material holdings of the Company, there are internal auditors (either as employees or outsourced). The audit reports are discussed in the audit committees and/or boards of directors of these corporations, on which senior executives of the Company serve. The internal auditor may, under the amended regulation, receive the audit reports of the subsidiaries' statements and hold meetings with each of the auditors of the subsidiary companies, at least once a year, to discuss the audit plan and its implementation in the subsidiary company.

Scope of employment

a. **Number of hours of employment in the year**

The audit's work program for 2007 included 10,800 audit hours. (In 2006 – 12,000 audit hours).
The internal audit unit at the end of the reporting year employed six fulltime auditors, including the internal auditor.

b. **Reduction in volume of internal auditor's work in the reporting year**

Due to the Company's reorganization and the retirement plan, the number of employees in the internal audit department was reduced in 2007 – from twelve auditors (including the internal auditor) to six auditors at the end of the reporting year (another auditor left after the reporting year – in January 2008).

8.6 Preparation for audit

a. **Work standards**

The Company's internal audit is prepared according to the binding standards of the Institute of Internal Auditors (I.I.A.).

b. **The board’s criteria for ensuring that the auditor complies with all the provisions in the standards**

In 2004 an external audit investigation of Bezeq’s internal audit department was carried out in compliance with Standard 1312 of the IIA, which requires one external audit every five years. The conclusion of this audit was that the work of the Company’s internal audit department complies with accepted professional internal audit standards

8.7 Accessibility to information

The internal auditor has been furnished with documents and information as stipulated in Article 9 of the Internal Audit Law, and she has been granted permanent direct access to the Company’s information systems, including financial data.

8.8 Auditor’s report

a. The internal auditor submits the audit reports in writing.

b. The internal auditor routinely submits the audit reports during the reporting year to the board chairman, CEO, audit committee chairman and committee members.

During the reporting year, 20 audit reports regarding the Company were prepared as well as a control risk survey and a total of 16 audit reports were submitted. Of these reports, 14 were prepared and submitted in the reporting year. Two reports prepared in 2006 were submitted in the reporting year. Another 6 reports prepared in the reporting year were submitted after the reporting year. The submission dates are as follows: January – one report (prepared in 2006), March – 3 reports (1 prepared in 2006), April – one report, July – 2 reports, August – one report, September – 2 reports, October – one report, November – 3 reports, December – control risk survey, January 2008 – 4 reports prepared in 2007, February 2008 – 2 reports prepared in 2007.

c. **Dates on which the audit committee convenes**

The board’s audit committee regularly discusses the audit reports submitted by the internal auditor during the reporting year. Over the course of the year, the committee held 24 meetings. The following table presents the meeting dates during the reporting year, divided into quarters:

Q1	Q2	Q3	Q4
February 20, 2007	April 17, 2007	July 8, 2007	October 21, 2007
March 14, 2007	May 15, 2007	July 15, 2007	November 7, 2007
	May 22, 2007	July 16, 2007	November 13, 2007
	June 5, 2007	August 30, 2007	November 20, 2007
	June 17, 2007	September 25, 2007	November 25, 2007
	June 21, 2007		December 13, 2007
	June 28, 2007		December 19, 2007
			December 24, 2007
			December 27, 2007
			January 15, 2008 This meeting was held instead of the meeting which had been scheduled for December 2007 and was postponed.

At these meetings, 21 audit reports were discussed. Ten of the reports discussed were published during the reporting year and eleven at the end of the previous reporting year.

In addition to discussions of the audit reports, the committee discussed additional subjects that it is obligated by law to discuss and decide.

8.9 Assessment of the board of directors regarding the work of the Internal Auditor

Based on sections 8.1 – 8.8 above and the reports received from the internal auditor, we, the Company's board of directors, believe that that the scope of the Company audit performed in 2007, the nature and continuity of the internal auditor's activities, and the work program, are reasonable in the circumstances and they achieve the objectives of the audit

8.10 Remuneration

a. The internal auditor is not one of the five highest salaried of the corporation's senior officers. The employment conditions of the internal auditor were discussed and approved by the audit committee and board of directors on August 30, 2007 and on October 21, 2007 and were approved later by the board of directors on October 25, 2007, as follows: Monthly salary of NIS 40,000 linked to the CPI at the date of appointment as the Company's acting internal auditor in August 2006. Annual target-based bonus determined by the audit committee and approved by the board of directors, up to 35% of the annual salary without related expenses.

b. As set forth in section (8.1)(e) above, the internal auditor holds options that were allocated to her as a Company employee before her appointment as internal auditor. The audit committee, in its meeting on January 20, 2008, recommended allocation of 100,000 options to the internal auditor as part of the options plan for middle managers. The allocation was approved by the board of directors on March 10, 2008 and as on the report date has not yet been implemented.

c. The board of directors believes that the remuneration received by the internal auditor does not affect her professional judgment.

8.11 Disclosure of exposure caused by non-compliance with conditions

The binding conditions in the matter of the Company's internal auditor have been fulfilled pursuant to the fourth appendix of Article 10(b)(11) or pursuant to any law.

9. Critical accounting estimates

The preparation of the financial statements according to international accounting principles obligates the management to make estimates and assessments that influence the reported values of assets and liabilities, income and expenses, and disclosure relating to contingent assets and liabilities. Management bases its estimates and assessments on past experience and on additional factors, value appraisals and opinions which it believes are relevant, taking into account the circumstances. The actual results can differ from those assessments based on various assumptions and conditions. Information on the principal matters of uncertainty in critical assessments and judgments in the application of the accounting policy is provided in the Financial Statements (see Note 2F). We believe that these assessments and estimates are critical because every change in them and in the assumptions has the potential to materially affect the financial statements.

Estimated useful life of property, plant and equipment

The estimated useful lives of fixed assets serve to determine the depreciation expenses that will be recorded in the reporting year.

The main part of the telecommunications infrastructure is managed in accordance with asset groups. The depreciation rates are based on the average useful life of an asset group and not of each individual asset. The useful life of an asset group is examined periodically and is based on past experience, taking into consideration expected technological changes, Company plans or other changes. If such changes take place earlier than expected or differently from expected, the remaining useful life of such assets may be shortened. This results in an increase in future depreciation expenses. If the changes take place later than expected, the remaining useful life may be extended, and this results in a decrease in the depreciation expenses. Given the importance of the Group's depreciation expenses in respect of the above changes, the effect on the operating results and the financial condition of the Group can be extremely significant.

Assessing the value of property, plant and equipment

Certain items of property, plant and equipment have been re-estimated to fair value upon the transition to IFRS based on their deemed cost, which was determined on the basis of their value on the transition date (January 1, 2005) in accordance with the Group's estimate based on the valuation of an external appraiser (attached as an appendix to the financial statements). In addition, the costs of dismantling, clearing and restoring sites were capitalized to the date of transition to IFRS.

The residual value of the Company's copper cables was assessed by the Company, based on the opinion of an external appraiser (attached as an appendix to the financial statements).

The use of estimates and value appraisals affects the fixed asset and depreciation expenses items – see Note 9 to the Financial Statements.

Liability for employee benefits

These liabilities are based on actuarial calculations which include many calculation assumptions which can be different in practice. The assumptions relate, *inter alia*, to interest rates for capitalization, mortality tables, wage creep and leaving rates. For details, see the actuary's letter attached to the financial statements.

With regard to changes in estimates in respect of these liabilities benefits, see Note 16 to the Financial Statements.

Deferred taxes

Deferred taxes are calculated at the tax rate expected to be in effect on their date of utilization. The tax benefit is included in the financial statements since the Company's business plans anticipate realization of the tax benefit. By nature, actual business results may differ from business plans, and this can affect the future realization of the tax benefit (see Note 8 to the financial statements).

Provisions and contingent liabilities

The Group's companies have contingent liabilities in amounts for which the possible maximum exposure is considerable. Among these, class actions of extremely significant amounts are pending against Group companies.

The Company makes regular estimates of the potential liabilities associated with every claim and complaint. It is naturally very difficult to determine the outcomes of the claims. The Company uses its best judgment and the assessments of its legal advisers to determine whether it is reasonable for the Company to bear the costs of settling claims and whether they can be reliably estimated.

Taking into consideration the uncertainty inherent in legal claims, it is possible that all or some of them will be concluded with charges for the Company, in amounts materially different from the provisions included in the financial statements, if any. For details of contingent liabilities, see Notes 15 and 17 to the financial statements.

Provision for uncertain debts

The financial statements include a provision for doubtful debts calculated in general terms from the volume of trade receivable balances, based on assessments and past experience, and specifically in respect of debts whose collection is in doubt. Actual results might differ from the assessments and estimates made, and could affect the results of operations accordingly (see Note 7 to the financial statements).

Goodwill and the value of investment in subsidiary companies

The value of the Company's holding in DBS and in Pelephone, for examining the need for a reduction in respect of impairment, is calculated by estimating the present value of future cash flows. The estimate is based on various forecasts, including, among others, projected cash flows for the coming years, a forecast of the number of subscribers and average revenue per user (ARPU), and the business forecasts. These are based on assumptions, estimates and sensitivity to changes in the discount interest rate (see Note 10 to the financial statements).

Options plan for employees

The fair value of the options granted to Company employees was determined according to the Company's assessment, based on the opinion of an external appraiser (attached as an appendix to the financial statements). The value set reflects the fair value of the services rendered to the Company in exchange for the options, and was measured by the Black and Scholes model and based on parameters that include the share price, the exercise price, volatility and average useful life. The value is also sensitive to a risk-free interest rate of government bonds (see Note 26 to the financial statements).

Assessment of financial instruments

The value of financial instruments is calculated according to the classification, based on market prices, present value of the cash flows and various value assessment models. The values are sensitive to changes in the parameters serving as the basis for these assessments (see Note 30 to the financial statements).

10. Opinion of process for approving the Company's financial statements

The board of directors is responsible for overseeing. The board of directors appointed a balance sheet committee with the following tasks and composition:

a. Most of the committee members have accounting and financial expertise, and at least one is an external director.

b. The balance sheet committee will discuss the financial statements before they are discussed in the board meeting, and will make recommendations to the board in respect of their approval. The committee will invite the auditors to participate in these discussions. The balance sheet committee will hold discussions and make recommendations to the board as follows: determining accounting policy and defining procedures for financial reporting and recording

c. The balance sheet committee will monitor changes in the accounting regulations and discuss their influence on the Company, discuss issues that will arise in the auditors' audit and discuss changes in the internal reporting systems.

d. The balance sheet committee will monitor and supervise implementation of the accounting policy that was determined and implementation of the regulations that were determined for financial reporting and recording.

e. The balance sheet committee will give an opinion on the abovementioned subjects, and other financial and accounting subjects, when discussing the financial statements and whenever a specific issue arises in a substantial scope in any of the abovementioned subjects.

f. The balance sheet committee will advise the board of directors in the matter of the scope of the auditors' work and their fee.

g. The balance sheet committee will be responsible for the board's contact with the auditors regarding their work.

The financial statements were discussed at the balance sheet committee and submitted to the board of directors for approval. The following officers attended the board discussion: board members – Shlomo Rodav, Eyal Yaniv, Menachem Inbar, Michael Grabiner, Stephen Grabiner, Elon Shalev, Arieh Saban, Kihara R. Kiarie, David Gilboa, Rami Nomkin, Yehuda Porat, Zehavit Cohen, Ran Gottfried and Yitzhak Edelman. In addition, the following officers attended: Avi Gabbay –CEO, Alan Gelman – CFO and Deputy CEO, Bosmat Chelouche – general counsel and Malka Dror – internal auditor. Representatives of Somekh Chaikin also participated in the discussion.

11. Miscellaneous

A. Disclosure concerning the remuneration of the auditor

Below are the fees paid to the auditors of the main companies in the Group for auditing services and audit-related services:

Company	Auditor	Details	2007 (NIS ‘000)		2006 (NIS ‘000)	
			Fee	Hours	Fee	Hours
Bezeq	Somekh Chaikin	Audit Other services	1,785 452	9,000 1,475	2,716 -	11,850 -
Pelephone	Kesselman & Kesselman and Somekh Chaikin	Audit			1,342	5,724
	Somekh Chaikin	Audit Other services	650 57	4,200 152		
DBS	Kesselman & Kesselman and Somekh Chaikin		621	4,300	737	3,754
Bezeq International	Somekh Chaikin and Brightman	Audit Other services	485 124	2,310 590	554 90	3,325 350

The fee in 2006 includes fees for auditing first adoption of International Financial Accounting Standards (IFRS).

B. Following an enquiry of the Securities Authority, it was decided to appoint an external examiner to investigate the issues arising from the Company's immediate reports on March 20, 2007 regarding approval of a stock options plan for employees and managers, on March 26, 2007 regarding approval of bonuses for officers, and on March 26, 2007 regarding restatement – following the letters of the Securities Authority to the Company on March 25, 2007 and March 28, 2007. The findings of the auditor and the subsequent board decisions, including approval of Mr. Yacov Gelbard's notice of the termination of his position as CEO and Mr. Avi Gabbay's entry into the position of CEO, are set forth in Section 2.20 Chapter A of the Periodic Report and the company's immediate statements published since then.

C. On October 25, 2007, the board of directors readopted a code of ethics. The code of ethics establishes principles and rules of conduct to direct the actions of officers, managers and employees. The code of ethics was consolidated in 2005 and a number of amendments and updates were incorporated in its new version. The board of directors authorized the management to act to assimilate the code of ethics in the Company and determined that the code of ethics will be a part of the Company's binding regulations.

D. On September 4, 2007 Shlomo Rodav was appointed chairman of the Company's board of directors. On the same day, the Company's board of directors resolved, pursuant to section 50 (a) of the Companies Law 5759-1999 and Articles 119 and 121.1 of the Articles of Association, that the powers of the CEO in everything relating to the Company's subsidiary companies, whether the holding in them is direct or indirect, (including Pelephone Communications Ltd., Bezeq International Ltd., DBS Satellite Services (1998) Ltd. and Walla! Communications Ltd., Bezeq Zahav Holdings Ltd. and BezeqCall Ltd.) would be transferred to the board of directors and the board of directors adopted the resolutions for implementation of the above.

We thank the managers, employees and shareholders of the Group's companies.

Shlomo Rodav Chairman of the Board of Directors	Avi Gabbay CEO