Chapter B of the Periodic Report

Directors' Report on the State of the Company's Affairs
For the year ended December 31, 2008

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, 2008 (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 another area of activity which is not material to the Group's operations, and it has been included in the Company’s financial statements on December 31, 2008 as a business segment consisting mainly of customer call center services and investment in a venture capital fund.

Revenues in the reporting year amounted to NIS 1,521 million compared with NIS 1,361 million in the corresponding year. The increase in revenues stemmed primarily from a decline in operating and general expenses from NIS 5,841 to NIS 5,437 which was offset against an increase in finance expenses from NIS 349 million to NIS 581 million. The revenues attributable to the Company's shareholders amounted to NIS 1,627 million compared with NIS 1,330 million in the corresponding year. The increase in revenues for the year stemmed primarily from an increase in revenues in all the segments with the exception of the multi-channel television segment where the loss increased. 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, 2008 amounted to NIS 14.31 billion, compared with NIS 15.16 billion on December 31, 2007, a decline of NIS 845 million. NIS 6.04 billion (42%) of the Group’s assets are property, plant and equipment, compared with NIS 6.06 billion (40%) on December 31, 2007.

The decrease in the Group’s assets stemmed from the fixed-line domestic communications segment. There was a decline in current assets in this segment, compared with the previous year, in the amount of NIS 499 million, mainly due to the realization of financial assets held for trading and a decline in cash and cash equivalents, which were used to pay a dividend of NIS 1.51 billion for repayment of liabilities and investment activity. Furthermore there was a decline in the customer balance mainly because the delay in the sending of customer invoices caused by the transition to a new billing system had to be overcome. In addition there was a decline in the depreciated cost of the fixed assets resulting from the gap between the depreciation expenses and the investment made in the reporting period.

In the cellular segment, assets increased from NIS 4.34 billion on December 31, 2007 to NIS 4.64 billion on December 31, 2008. Most of the increase was due to an investment in frequency rights and fixed assets for the operation of the new network (using UMTS/HSPA technology). Moreover there was an increase in the customer balance which stemmed primarily from the termination of the discounting of credit card payments.

On the other hand, there was a reduction in cash balances mainly because of the distribution of a dividend and there was also a decrease in inventory caused by a reduction in the inventory of CDMA handsets.

In the international communication, internet and NEP services segment, assets increased from NIS 887 million on December 31, 2007 to NIS 994 million on December 31, 2008. The increase stemmed primarily from a rise in advance long-term expenses for capacity usage rights, a rise in

cash balances and a rise in customer balances and in inventory caused by an increase in all the components of the segment's operations.

In the multi-channel television segment there was a moderate increase in total assets from NIS 1.10 billion on December 31, 2007 to NIS 1.13 billion on December 31, 2008.

C. The shareholders' equity attributed to Company shareholders on December 31, 2008 amounted to NIS 4.72 billion, comprising 33% of the total balance sheet, compared with NIS 4.54 billion on December 31, 2007, which comprised 30% of the total balance sheet. The increase in shareholders' equity stemmed primarily from the Group's revenues for the year most of which was offset by the distribution of a dividend in the amount of NIS 1.51 billion.

The Group's debt to financial institutions and debenture holders on December 31, 2008 amounted to NIS 6.05 billion, compared with NIS 6.74 billion on December 31, 2007. The decrease is mainly due to payment of debentures in the domestic fixed line communications segment in the amount of NIS 593 million and payment of loans and debentures in the cellular segment. The Group's total payment of debentures, loans and short-term borrowings amounted to NIS 912 million. The decrease was partially offset mainly by a revaluation of CPI-linked loans and debentures caused by a rise in the CPI.

D. The Company's auditors have highlighted the financial position of D.B.S. Satellite Services (1998) (DBS) as at December 31, 2008, in the financial statements. As mentioned in Notes 13C(3) and 33(3) to the financial statements, at December 31 2008 DBS is not in compliance with the financial covenants set for it, after receipt of a relief in connection with those covenants on March 5, 2008, updating the stipulations for 2008. Subsequent to the balance sheet date DBS is in compliance with the financial conditions set for it, following updates to the conditions for 2008. After the balance sheet date DBS received a relief in connection with the financial criteria as at December 31, 2008, and consequently as at the approval date of these statements DBS is in compliance with the conditions set in the financing agreement. The continuation of DBS's operations is also conditional on compliance with the conditions set for 2009 and/or with further reliefs. 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 by DBS's board of directors.

2. Results of operations

A. Principal results

There were no changes in the Group's revenues in 2008 compared with the previous year and they amounted to NIS 12.41 billion. Revenue stability stems from an increase in revenues in the cellular and multi-channel television segment which was fully offset by a decrease in the fixed-line domestic communications segment.

The Group's depreciation and amortization expenses amounted to NIS 1,703 million compared with NIS 1,769 million in the previous year, a decrease of 3.7%.

Most of the decline stemmed from the fixed-line domestic communications segment and the multi-channel television segment and it was partially offset by an increase in revenues from the cellular segment.

In 2008 the Group's salary expenses amounted to NIS 2,354 million compared with NIS 2,375 million in the previous year, a decrease of 1%. The decrease stemmed primarily from a decline in salary expenses in the fixed-line domestic communications segment which was partially offset by an increase in salary expenses in the other Group segments.

In 2008 the Group's operating and general expenses amounted to NIS 5,437 million compared with NIS 5,841 million in the previous year, a decrease of 7%. The decrease stems primarily from a decline in expenses in all the Group's principal segments.

Earnings for the year which will be attributed to the Company's shareholders in 2008 amounted to NIS 1,627 million. The earnings were affected by the early application of international standards whereby 58% of DBS's losses were included in the Company's shareholders' share – for details see Note 3V(1) of the financial statements.

B. **Operating segments**

Below are operations data by segment presented in accordance with the Group's operating segments:

Revenues by operating segments	1-12/2008		1-12/2007	
	NIS millions	% of total revenues	NIS millions	% of total revenues
Fixed-line domestic communications	5,498	44%	5,713	46%
Cellular	4,713	38%	4,684	38%
International communication Internet and NEP	1,306	11%	1,304	11%
Multi-channel television services	1,513	12%	1,415	11%
Other and offsets	(623)	(5%)	(716)	(6%)
Total	12,407	100%	12,400	100%

Operating profit by operating segments	1-12/2008		1-12/2007	
	NIS millions	% of total earnings	NIS millions	% of total earnings
Fixed-line domestic communications	1,475	27%	1,319	23%
Cellular	933	20%	805	17%
International communication Internet and NEP	242	19%	204	16%
Multi-channel television services	177	12%	56	4%
Other and offsets	(10)		(8)	
Consolidated operating profit/ Percentage of the group's revenues	2,817	23%	2,376	19%

Fixed-line domestic communications segment

Revenues:

Revenues in 2008 amounted to NIS 5.5 billion compared with NIS 5.71 billion in the previous year, a decline of 3.8%.

The decline in the segment's revenues stemmed from a decrease in interconnect fees to the cellular networks in the amount of NIS 137 million (there was a parallel decrease in expenses). An additional decrease stemmed from a decrease in the number of lines (primarily as a result of number mobility), a decrease in call traffic and a tariff reduction in June 2007 and June 2008. The decrease in revenues was moderated mainly by ongoing growth in revenues from high-speed internet service (ADSL) caused by an increase in subscriber numbers and in domestic network sales. There was also an increase in revenues from data communication services.

Costs and expenses:

Depreciation and amortization expenses in 2008 amounted to NIS 852 million compared with NIS 941 million in the previous year, a decrease of 9.5%. The decrease was caused by the end of the depreciation of fixed assets, a decrease in investments in new assets and a change in the useful life and scrap value estimate of fixed assets.

Salary expenses in 2008 amounted to NIS 1,202 million compared with NIS 1,293 million in the previous year, a decrease of 7%. The decrease in salary expenses stemmed primarily from employee retirement and a decrease in ancillary salary expenses which was partially offset by share-based payments and salary updates.

Operating and general expenses in 2008 amounted to NIS 1,873 million compared with NIS 2,121 million in the previous year, a decline of 11.7%. The decrease stemmed primarily from a decrease in interconnect expenses to the cellular networks in the amount of NIS 139 million, together with a decrease in revenues, and from a decrease in maintenance expenses by subcontractors and marketing expenses, as part of the application of streamlining processes. Part of the decrease stemmed from an update in provisions for royalties and international communication providers.

Other operating expenses, net in 2008 amounted to NIS 96 million compared with NIS 39 million in the previous year. This was caused mainly by the recording of provisions for claims in the previous year compared with an increase in retirement expenses for early retirement severance pay in the reporting year and a decrease in capital gains.

Profitability:

Operating profit in the segment in 2008 amounted to NIS 1,475 million compared with NIS 1,319 million in the previous year, an increase of 11.8%. The improvement in operating profit stems from the changes described above in the expenses and revenue items.

Cellular segment

Revenues:

In 2008 revenues in the segment amounted to NIS 4.71 billion compared with NIS 4.68 billion in the previous year, an increase of 0.6%.

The increase stemmed primarily from a rise in the number of subscribers, in particular 3G subscribers, which led to a rise in revenues from usage fees and revenues from content services. The increase in revenues was partially offset by erosion in the average subscriber revenue which was caused mainly by tariff erosion and a decrease in traffic minutes. Moreover there was a decrease in revenues from the sale of terminal equipment caused by a decline in the number of sales and upgrades of end user equipment which was offset by an increase in sales and upgrade prices.

Costs and expenses:

Depreciation and amortization expenses in 2008 amounted to NIS 523 million compared with NIS 479 million in the previous year, a decrease of 9.2%. The increase stems partly from the accelerated depreciation of fixed asset items resulting from the transition to the new network.

Salary expenses in 2008 amounted to NIS 638 million compared with NIS 598 million in the previous year, an increase of 6.7%. The rise in salary expenses stemmed primarily from the share-based payment plan for managers.

Operating and general expenses in 2008 amounted to NIS 2,619 million compared with NIS 2,802 million in the previous year, a decrease of 6.5%. The decrease stemmed primarily from a decrease in the number of handsets sold and upgraded and from their price which was partially offset by a rise in site maintenance expenses.

Profitability:

Operating profit in the segment in 2008 amounted to NIS 933 million compared with NIS 805 million in the previous year, an increase of 15.9%. The improvement in operating profit stemmed from the changes described above in the expenses and revenue items.

International communication, internet and NEP segment

Revenues:

In 2008 revenues in the segment amounted to NIS 1,306 million compared with NIS 1,304 million in the previous year. Segment revenues remained similar in the reporting years, however there was a decline in revenues from call transfer activity between communication providers in the world and from PBX sales activity. On the other hand there was an increase in segment revenues from outbound international calls following an increase in the number of outbound minutes as well as an increase in revenues in the internet sector caused by an increase in the number of broadband customers and an increase in integration operations and communication solutions for corporate customers.

Costs and expenses:

Depreciation expenses in 2008 amounted to NIS 80 million compared with NIS 87 million in the previous year, a decrease of 7%. The decrease stems from the end of the depreciation of assets in 2007.

Salary expenses in 2008 amounted to NIS 260 million compared with NIS 240 million in the previous year, an increase of 8.3%. The increase in salary expenses stems from the share-based payment plan for managers, a headcount increase and salary updates.

Operating and general expenses in 2008 amounted to NIS 724 million compared with NIS 773 million in the previous year, a decrease of 6.3%. The decrease stemmed primarily from a reduction in call transfer activity between communication operators in the world together with a decrease in revenues.

Profitability:

Operating profit in the segment in 2008 amounted to NIS 242 million compared with NIS 204 million in the previous year, an increase of 18.6%. The improvement in operating profit stems from the changes described above in the expenses and revenues items.

Multi-channel television segment

Revenues:

Revenues in the segment in 2008 amounted to NIS 1,513 million compared with NIS 1,415 million in the previous year, an increase of 7%. The increase stemmed from a rise in the number of subscribers and a rise in average customer revenue.

Costs and expenses:

Depreciation and amortization expenses in 2008 amounted to NIS 250 million compared with NIS 273 million in the previous year, a decrease of 8.5% caused by the end of depreciation and a change in asset useful life estimates.

Salary expenses in 2008 amounted to NIS 197 million compared with NIS 180 million in the previous year, an increase of 9.4% caused by a rise in headcount primarily resulting from the end of installation agreements with subcontractors.

Operating and general expenses in 2008 amounted to NIS 888 million compared with NIS 906 million in the previous year, a decrease of 2%. The decrease in expenses was primarily in space section costs for broadcasting and marketing expenses.

Profitability:

Operating profit in the segment in 2008 amounted to NIS 177 million compared with NIS 56 million in the previous year, an increase of 216%. The improvement in operating profit stems primarily from the above-mentioned increase in revenues.

C. **Financing expenses, net**

The Group's net financing expenses in 2008 amounted to NIS 581 million compared with NIS 349 million in the previous year, an increase of 66.5%. The increase stems from finance revenues of NIS 96 million which were formerly recorded because of a change in the minority shareholder loan capitalization rate in the multi-channel television segment. Moreover there was an increase in linkage differential expenses (less the effect of hedging transactions) because of an increase in the index to which most of the Group's debit balance is linked. In addition, there was a decrease in deposit interest revenues because of a decrease in the Group's liquid financial balances.

In the domestic fixed line communications segment in 2008, net financing expenses amounted to NIS 125 million compared with NIS 188 million in the previous year, a decrease of 33.5%. The decrease in net financing expenses compared with the previous year stemmed primarily from an increase in revenues from shareholders' loans for DBS amounting to NIS 117 million and a decrease in interest expenses resulting from a decrease in the financial liabilities. The decrease in interest expenses was partially offset against a decrease in linkage differentials and a decrease in financing income from deposits and investments in securities.

In the cellular segment net financing revenues amounted in 2008 to NIS 2 million compared with financing expenses of NIS 5 million in 2007.

In the multi-channel television segment net financing expenses in 2008 amounted to NIS 441 million compared with NIS 168 million in the previous year, an increase of 163%. Most of the change stemmed from finance revenue amounting to NIS 213 million which was recorded in the third quarter of the previous year because of a change in the capitalization rate of shareholders' loans. Furthermore the rise in the index rate in the period caused a rise in the financing expenses.

D. **Income tax**

The Group's tax expenses in the reporting year amounted to NIS 720 million, representing approximately 32% of pre-tax profit, compared with NIS 672 million in the previous year, representing 33% of pre-tax profit. Most of the decrease in the rate of tax on profits before income tax is due to a tax rate reduction as well as cancellation of the inflation condition tax law. The decrease is moderated by the increase in DBS's losses which may not be offset for tax purposes.

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

	Q1 2008	Q2 2008	Q3 2008	Q4 2008	2008	2007	Increase (Decrease)	%
Revenues [(1)]	3,100	3,086	3,159	3,062	12,407	12,400	7	0%
Costs and expenses [(2)]	2,436	2,286	2,337	2,531	9,590	10,024	(434)	(4%)
Operating profit	664	800	822	531	2,817	2,376	441	19%
Financing expenses – net [(3)]	100	183	186	112	581	349	232	66%
Earnings before Group's equity in profits of associates	564	617	636	419	2,236	2,027	209	10%
Equity in profits of associates	1	1	2	1	5	6	(1)	(17%)
Profit before income tax	565	618	638	420	2,241	2,033	208	10%
Income tax	180	205	207	128	720	672	48	7%
Profit for the year	385	413	431	292	1,521	1,361	160	12%
Attributable to:								
The Company's equity holders	411	456	462	298	1,627	1,330	297	22%
Non-controlling interest	(26)	(43)	(31)	(6)	(106)	31	(137)	-
Profit for the year	385	413	431	292	1,521	1,361	160	12%

Comparison of 2008 fourth quarter results with the results of the third quarter

Details of the material changes:

(1) Total revenues declined by NIS 97 million of which NIS 76 million was in the mobile telephone segment. The decline in the segment's revenues was primarily in revenues from the sale of end user equipment and cellular services.

(2) The total costs and expenses increased by NIS 194 million compared with the prior quarter. Most of the increase originates from the fixed-line domestic communications segment. In this segment there was an increase in the fourth quarter resulting from the recording of a provision for early retirement caused by the decision to expand the early retirement agreement also for 2009. In addition, in this quarter there were updates of other actuarial liabilities. An increase in capital gains in the quarter partially offset these costs.

(3) Net financing expenses decreased by NIS 74 million compared with the prior quarter, mainly as a result of the decline in the CPI to which most of the Group's liabilities are linked.

3. Liquidity and sources of financing

Consolidated cash flows generated by operating activities in 2008 amounted to NIS 3.41 billion, compared with NIS 2.95 billion in the previous year, an increase of NIS 468 million. The increase in cash flows generated by operating activities is mainly due to the increase in operating profit of all the

Group's segments and a change in the accounts receivable balance which was partially offset by a change in the accounts payable balance and provisions.

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 1,300 million invested in development of communications infrastructures, and NIS 469 million in intangible assets and deferred expenses, compared with investments amounting to NIS 973 million and NIS 273 million, respectively, in the previous year. During the reporting year, the Group realized investments in net financial assets of NIS 332 million, compared with net realizations of NIS 705 million in the prior year.

In the reporting year, the Group repaid debts and paid interest of NIS 1,103 million, of which NIS 714 million was on account of debentures, NIS 148 million in loans, NIS 50 million in short-term credit, and NIS 243 million in interest payments. In contrast the Group received a receipt for the removal of net derivative financial instruments in the amount of NIS 52 million. This compares with the repayment of a net debt and interest payments amounting to NIS 3,116 million in the previous year. In the reporting year a cash dividend of NIS 1.51 billion was paid and in the previous year the amount was NIS 2.86 billion.

The monthly average short-term credit balance from banks in 2008 amounted to NIS 79 million. The monthly average of long-term liabilities to financial institutions and debenture holders in 2008 amounted to NIS 6,193 million.

The working capital deficit on December 31, 2008 was negative, and amounted to NIS 1,279 million, compared with NIS 919 million on December 31, 2007. Most of the increase in working capital deficit is derived from a decrease in working capital in the cellular segment which was mitigated by an improvement in the international communication, internet and NEP segment.

The Company's board has examined the Company's projected cash flow, including credit sources and credit-raising options, and has determined despite the deficit in working capital, the Company does not have a liquidity problem.

The above information includes forward-looking information which is based on the Company's assessments. The actual results might differ materially from the assessments described above if a change occurs in one of the factors taken into account when making them.

4. The connection between the compensation granted pursuant to Article 21 and the contribution made by the recipient to the corporation in relation to each of the five highest salary recipients among its officers

The board of directors believes that the remuneration paid to the five senior officers as described in section 7A of chapter D of this periodic report is fair and reasonable considering the size of the Corporation, the scope and complexity of its operations and businesses as well as the assignments and responsibility shouldered by these senior officers. The considerations guiding the board of directors of the Company (or of the subsidiary, where applicable) in the determination of the remuneration of the senior officers is based, inter alia on the status and position of each one, his contribution to the advancement of the Corporation and its financial results. Moreover, the board of directors believes that the scope of remuneration of these senior officers does not deviate from what is customary in similar corporations in the market.

5. Group involvement in the community and donations

The Group is active in the community through its involvement in social institutions and organizations which are active for education, welfare and other purposes. Its contributions in the reporting year amounted to NIS 5.3 million. In addition, Group employees volunteer in additional and diverse community involvement activities. In the Cast Lead operation the Company provided public telephones, laptop computers and free internet use to residents in the south of the country and soldiers. The Group intends to increase its philanthropy budget for 2009.

6. Exposure to and management of market risks

Responsibility for management of the Company's market risks

The person responsible for management of the Company's market risks is Alan Gelman, the Deputy CEO and CFO. For details of his education and experience, see Section 12 (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.

On June 26, 2008 the Company adopted a financial exposure policy which replaces the previous exposure management policy. A board resolution allows for a transition of three months, with the aim of allowing the adjustment of exposure management to the new policy. The main relevant transactions in the reporting period were made according to the prior exposure policy as described in the board of directors' report from 2007. The primary purpose of the new policy is to minimize significant exposures to the market risks which are liable to affect the Group's cash flow and financial results. In accordance with the said policy the Company will implement hedging transactions, partially, based on circumstances and its discretion, mainly in order to reduce its exposure to changes in foreign currency exchange rates and in the CPI.

The Company will monitor the Group's exposure management on a monthly basis, including recommendations for change in respect of the exposure and management, if required.

At least once a year, the board of directors of the Company and of each of the main subsidiaries will discuss the exposure to financial risks. If the overseeing level considers a deviation from the goals, its recommendations will be presented to the board of directors.

Inflation – the Company has a significant surplus of liabilities over CPI-linked assets and the bulk of its financial exposure derives from the risk of a rise in inflation. The rate of inflation also has an effect on the Company's revenues and operating results in the course of the year.

The Company's tariff updating mechanism, which was laid down in regulations and is reviewed once a year, is influenced by the CPI. 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 over the year. The rate of inflation affects the Company's expenses but some of these expenses, mainly salary expenses, have other direct or indirect linkage mechanisms.

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 changes in the rate of inflation. In order to minimize this exposure, the board of directors of the Company decided to implement full or partial hedging transactions at its discretion, in accordance with the following:

A. Hedging activity will be implemented mainly by means of CPI-shekel forward transactions which guarantee a designated rise in the CPI over a designated period.

B. Transactions will be implemented after deliberation and in accordance with market trading restrictions and on occasions where the price is deemed to be attractive in relation to the Bank of Israel Inflation Target Center.

C. It will be possible to reduce a hedging position by closing existing transactions before their expiry date.

D. As long as this exposure is more than NIS 500 million, the hedging rate will not be less than 20% of the exposure and will not exceed 80% of the exposure; as long as this exposure is below NIS 500 million, the hedging rate will not exceed 50% of the exposure.

In the reporting period the Company implemented hedging transactions against the index since they were made as forward transactions. The financial statements include financing revenues of NIS 5 million from these hedging transactions.

Interest – The Company's exposure to change in the interest rate largely depends on the character of its financial liabilities and assets as well as future financial requirements, The Company's debentures bear fixed interest and therefore a 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 hedge its accounting exposure to exchange rate risks subject to the following principles and rules:

1. The unhedged exposure to exchange rate risks would not exceed an amount equivalent to $200 million
2. Hedging of purchase and/or investment transactions would take place, if at all, on the date of the purchase and/or investment decision and the decision to do this would be part of the purchase and/or investment decision itself.

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

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 a small part 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. According to this investment policy the Company has no authority to invest in shares as part of the management of its investment portfolio. As at the date of publication of the reports, the total investment in securities is negligible.

Risks and risk management in the consolidated companies – According to the decision of the board of directors, each of the companies in the Group is required to manage a risk policy and routinely monitor performance. The persons responsible for management of the market risks in the principal consolidated companies are the deputy CFOs of those companies. Pelephone's policy is to partly hedge its accounting and cash flow exposure to market risks based on its assessments and expectations of the parameters affecting the risk. DBS enters into future dollar/shekel hedging transactions in order to protect its projected cash flow.

The consolidated financial statements include finance expenses of NIS 22 million from hedging transactions, including forward transactions and purchase of options in the reporting year.

Linkage based report – Note 31 to the Financial Statements includes information on the linkage terms of the financial balances in the Group.

For further details of the Group's financial risk management see Note 30 to the financial statements.

Below is an analysis of the sensitivity of the Group's assets and liabilities to changes in foreign currency exchange rates, the CPI, interest and market prices of securities.

Sensitivity analysis 2008 (in NIS millions)

Sensitivity to changes in the dollar/NIS exchange rate – 2008

The table shows the items sensitive to fluctuations in the dollar/shekel exchange rate. The sensitivity of the items in the balance sheet was examined, 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. The fair value of the firm commitments was calculated by discounted future cash flow. The Group has minor exposure to changes in the exchange rate of other foreign currencies, with the exception of the US dollar.

	Profit (loss) from changes		**Fair value**	**Profit (loss) from changes**	
	10%	**5%**	**At a dollar rate of 3.802**	**-5%**	**-10%**
Cash	1	1	12	(1)	(1)
Trade receivables	7	3	70	(3)	(7)
Long-term trade receivable	1	1	15	(1)	(1)
Investments	5	3	50	(3)	(5)
Trade payables	(25)	(13)	(251)	13	25
Firm commitments - suppliers	(42)	(21)	(417)	21	42
Firm commitments – space segments	(54)	(27)	(539)	27	54
Firm commitments – vehicle leasing	(1)	(1)	(14)	1	1
Firm commitments - rent	(4)	(2)	(36)	2	4
Guarantees	(7)	(4)	(75)	4	7
Hedging instruments not recognized for accounting					
Dollar/shekel forward transactions	22	11	3	(11)	(22)
Options					
Dollar/shekel sale option	2	2	(3)	(3)	(7)
Dollar/shekel purchase option	3	2	2	(1)	(2)
Total	**(92)**	**(45)**	**(1,183)**	**45**	**88**

Sensitivity to changes in the CPI – 2008

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 analysis of sensitivity to changes in the CPI includes an additional scenario of 1.5% per month (up and down) which examines the most extreme monthly change in the CPI which occurred in the past ten years (a monthly change of 1.5% in April 2002).

The Group has debentures and loans from banks and other sources, which are linked to the CPI. The Group also has firm commitments (for rent, vehicle leasing and agreements with suppliers), which are linked to the CPI. The fair value of the firm commitments was calculated by discounting the future cash flow.

	Profit (loss) from changes			Fair value	Profit (loss) from changes		
	1.5%	**0.2%**	**0.1%**		**(0.1%)**	**(0.2%)**	**(1.5%)**
Trade receivables	-	-	-	24	-	-	-
Long-term trade receivables	1	-	-	35	-	-	(1)
Other liabilities and provisions	(2)	-	-	(155)	-	-	2
Other long-term liabilities	-	-	-	(6)	-	-	-
Firm commitments – vehicle leasing	(3)	-	-	(215)	-	-	3
Firm commitments – suppliers	(1)	-	-	(36)	-	-	1
Firm commitments - rent	(9)	(1)	(1)	(588)	1	1	9
Guarantees	-	-	-	(8)	-	-	-
Debentures issued to financial institutions and others	(8)	(1)	(1)	(554)	1	1	8
Debentures issued to financial institutions and others	(12)	(2)	(1)	(820)	1	2	12
Debentures issued to financial institutions and others	(11)	(1)	(1)	(724)	1	1	11
Debentures issued to the public – Series 4	(15)	(2)	(1)	(1,031)	1	2	15
Debentures issued to the public – Series 5	(27)	(4)	(2)	(1,810)	2	4	27
Loans from banking institutions	(5)	(1)	-	(317)	-	1	5
Loans from others	(2)	-	-	(156)	-	-	2
Loans provided by the minority in a subsidiary	(7)	(1)	-	(449)	-	1	7
Hedging instruments not recognized for accounting							
CPI forward transactions	26	3	2	(5)	(2)	(3)	(26)
Total	**(75)**	**(10)**	**(5)**	**(6,815)**	**5**	**10**	**75**

Sensitivity to changes in real shekel interest rates – 2008

The Group's companies have index-linked debentures at fixed interest. These debentures are sensitive to changes in the real shekel interest rate. Debentures issued to the public – Series 4 – were traded on December 31, 2008 with a yield of 3.83% and an average duration of 1.36. Debentures issued to the public – Series 5 – were traded on December 31, 2008 with a yield of 3.92% and an average duration of 4.32.

Changes in the fair value of debentures were calculated by discounting the future cash flows. The fair value of the debentures is presented at the stock market value, in other words, by multiplying the market price on December 31, 2008 with the quantity of the issued nominal value. The fair value of non-negotiable debentures was calculated by discounting the future cash flows at an average interest rate of 4.16% to 9.1%. Loans from banks and other institutions are linked to the CPI and sensitive to changes in real shekel interest. These loans were discounted at an average interest rate of 5.68% - 11.30%.

	Profit (loss) from changes		Fair value	Profit (loss) from changes	
	10%	5%		-5%	-10%
Debentures issued to financial institutes and others	2	1	(554)	(1)	(2)
Debentures issued to financial institutes and others	11	5	(820)	(5)	(11)
Debentures issued to financial institutes and others	24	12	(724)	(12)	(25)
Debentures issued to the public -Series 4	5	3	(1,031)	(3)	(5)
Debentures issued to the public - Series 5	29	15	(1,810)	(15)	(30)
Bank loans	4	2	(317)	(2)	(4)
Loans from others	8	4	(156)	(4)	(8)
Hedging instruments not recognized for accounting					
CPI forward transactions	(5)	(2)	(5)	2	5
Total	**78**	**40**	**(5,417)**	**(40)**	**(80)**

.

Sensitivity to changes in nominal shekel interest rates – 2008

The sensitivity analysis of the shekel interest rate includes another scenario (12% up and down), which examines the most extreme daily change that occurred in the last ten years (a daily change of 12% in December 2001). The Group has accounts receivable in installments. The fair value of these balances is calculated by discounting the future cash flow at an interest rate of 7.5%. The Group has unlinked loans from banking institutions at fixed interest. The loans were discounted at an average interest rate of 7.52%.

	Profit (loss) from changes			Fair value	Profit (loss) from changes		
	12%	10%	5%		-5%	-10%	-12%
Shekel deposits	-	-	-	556	-	-	-
Accounts receivable paid in installments	(8)	(7)	(3)	1,041	3	7	8
Investments, deposits and debit balances	(1)	(1)	-	128	-	1	1
Long-term accounts receivable	-	-	-	34	-	-	-
Loans from banking corporations	17	14	7	(808)	(7)	(15)	(18)
Hedging instruments not recognized for accounting							
CPI forward transactions	5	4	2	(5)	(2)	(4)	(5)
Dollar / shekel forward transactions	-	-	-	3	-	-	-
Options							
Dollar / shekel sale option	-	-	-	(3)	-	-	-
Dollar / shekel purchase option	-	-	-	2	-	-	-
Total	**13**	**10**	**6**	**948**	**(6)**	**(11)**	**(14)**

Sensitivity to changes in US dollar interest rates – 2008

The sensitivity analysis of the dollar interest rate includes another scenario (15% up and down), which examines the most extreme daily change that occurred in the last ten years (a daily change of 15% in June 2003).

	Profit (loss) from changes			Fair value	Profit (loss) from changes		
	15%	10%	5%		-5%	-10%	-15%
Dollar deposits	-	-	-	5	-	-	-
Firm commitments – space segments	20	13	7	(539)	(7)	(14)	(21)
Hedging instruments not recognized for accounting							
Dollar/shekel forward transactions	-	-	-	3	-	-	-
Options							
Dollar / shekel sale option	-	-	-	(3)	-	-	-
Dollar / shekel purchase option	-	-	-	2	-	-	-
Total	**20**	**13**	**7**	**(532)**	**(7)**	**(14)**	**(21)**

Sensitivity analysis 2008 (in NIS millions)

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

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. The fair value of the firm commitments was calculated by discounting the future cash flow. The Group has insignificant sensitivity to changes in the exchange rate of other foreign currencies, with the exception of the US dollar.

	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)
Accounts receivable and debit balances	0.1	0.1	1	(0.1)	(0.1)
Investments	10	5	9	(5)	(10)
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	(61)	(31)	611	31	61
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	**(88)**	**(45)**	**(1,258)**	**45**	**88**

Sensitivity to changes in the CPI – 2007

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. Another scenario of 1.5% (up and down) reflects the most extreme change that occurred in the last ten years (a monthly change of 1.5% in April 2002) in the CPI. The Group has debentures and loans from banks and other sources which are linked to the CPI. Additionally, the Group has firm commitments (for rent and vehicle leasing agreements with suppliers) which are linked to the CPI. The fair value of the firm commitments was calculated by discounting the future cash flow.

	Profit (loss) from changes			**Fair value**	**Profit (loss) from changes**		
	1.5%	**0.2%**	**0.1%**		**0.1%**	**0.2%**	**1.5%**
Trade receivables	0.2	-	-	15	-	-	(0.2)
Investments and debit balances	0.1	-	-	11	-	-	(0.1)
Long-term trade receivables	0.3	-	-	24	-	-	(0.3)
Other liabilities and provisions	(2)	(0.3)	(0.1)	(131)	0.1	0.3	2
Firm commitments – vehicle leasing	(0.7)	(0.1)	(0.1)	(52)	0.1	0.1	0.7
Firm commitments - rent	(9)	(1)	(1)	(579)	1	1	9
Firm commitments - suppliers	(2)	(0.2)	(0.1)	(105)	0.1	0.2	2
Guarantees	(0.5)	-	-	(33)	-	-	0.5
Debentures issued to financial institutions and others	(12)	(2)	(1)	(776)	1	2	12
Debentures issued to financial institutions and others	(14)	(2)	(1)	(928)	1	2	14
Debentures issued to financial institutions and others	(10)	(1)	(1)	(650)	1	1	10
Debentures issued to the public- series 4	(20)	(3)	(1)	(1,340)	1	3	20
Debentures issued to the public- series 5	(26)	(3)	(2)	(1,706)	2	3	26
Bank loans	(7)	(1)	(0.5)	(461)	0.5	1	7
Loans from others	(2)	(0.3)	(0.1)	(137)	0.1	0.3	2
Loans provided by the minority in a subsidiary	(6)	(1)	(0.4)	(375)	0.4	1	6
Hedging instruments not recognized for accounting							
Hedging transactions against the index	54	7	4	53	(4)	(7)	(54)
Total	**(56.6)**	**(7.9)**	**(4.3)**	**(7,170)**	**4.3**	**7.9**	**56.6**

Sensitivity to changes in real shekel interest rates – 2007

The Group's companies have index-linked debentures at fixed interest. The debentures are sensitive to changes in the real shekel interest rate. The debentures issued to the public – Series 4 – were traded on December 31, 2007 with a yield of 3.04% and an average duration of 1.83. The debentures issued to the public – Series 5 – were traded on December 31, 2007 with a yield of 4.45% and an average duration of 5.07.

Changes in the fair value of debentures was presented by discounting the future cash flows. The fair value of the debentures is presented according to the value on the stock exchange, in other words, by multiplying the market price on December 31, 2007 by the amount of the issued nominal value. The fair value of non-negotiable debentures was calculated by discounting the future cash flows by an average interest rate of 4.18% to 8.14%. Loans linked to the CPI and sensitive to changes in real shekel interest, from banks and other institutions, were discounted at an average interest rate of 3.88 to 10.84%.

	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 institutions and others	5	2	(776)	(2)	(5)
Debentures issued to financial institutions and others	12	6	(928)	(6)	(12)
Debentures issued to financial institutions 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)**

Sensitivity to changes in nominal NIS interest rates – 2007

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

	Profit (loss) from changes			**Fair value**	**Profit (loss) from changes**		
	12%	**10%**	**5%**		**-5%**	**-10%**	**-12%**
Investments, deposits and debit balances		(1)	(0.4)	150	0.4	1	
Long-term trade receivables		(2)	(1)	176	1	2	
Trade receivables paid in installments		(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)**

Sensitivity to changes in dollar interest rates - 2007

The sensitivity analysis of the dollar interest rate includes another scenario (15% up and 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.

	Profit (loss) from changes			Fair value	Profit (loss) from changes		
	15%	10%	5%		-5%	-10%	-15%
Firm commitments – space segments	24	16	8	(611)	(8)	(17)	(26)
Hedging instruments not recognized for accounting							
Dollar/shekel forward transactions	(1)	(0.4)	(0.2)	(11)	0.2	0.4	1
Total	**23**	**15.6**	**7.8**	**(622)**	**(7.8)**	**(16.6)**	**(25)**

Sensitivity to changes in prices of negotiable shekel securities – 2007

The Company has unlinked shekel debentures. The sensitivity analysis of the shekel debentures (unlinked) was made at values of 1.25% and 2.50%, based on a historical examination of the maximum change in prices of shekel debentures.

	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)**

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

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 debentures.

	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)**

Sensitivity to changes in prices of negotiable securities – 2007

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.

	Profit (loss) from changes			Fair value	Profit (loss) from changes		
	118%	10%	5%		-5%	-10%	80%
Shares	-	3	2	34	(2)	(3)	-
Pointer share	5	0.4	0.2	4	(0.2)	(0.4)	(3)
Convertible debentures (shares)	-	0.1	0.1	1	(0.1)	(0.1)	-
Other	-	0.2	0.1	2	(0.1)	(0.2)	-
Total	**5**	**3.7**	**2.4**	**41**	**(2.4)**	**(3.7)**	**(3)**

7. Directors with accounting and financial expertise and independent directors

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 Rubinstein, David Gilboa, Eyal Yaniv (external director) and Yitzhak Edelman (external director). For information about their relevant education and experience, see Section 11 in Chapter D of the Periodic Report.

C. The Company has not adopted in its articles the directive concerning the percentage of independent directors as defined in Article 19.2 (E) of the Companies Law.

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 acting), 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)

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. Ms. 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 has exercised and sold 29,526 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 addition, pursuant to a resolution adopted by the board of directors on March 10, 2008, the internal auditor has been allocated 100,000 options as part of allocation of options to middle-managers in the Company according to an outline published on March 11, 2008. The Company believes that these holdings do not affect the quality of the internal auditor's work.

f. 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 Company's internal audit procedure. The procedure was updated and approved by the board's audit committee on December 27, 2007.

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

To examine the propriety of the operations of the Company, its officers and senior employees from the following aspects: compliance with applicable laws and regulations and proper business practices; principles of sound management, efficiency, thrift 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.

Authorities of the internal auditor according to the Company's internal audit procedure

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. The internal auditor will be invited to all meetings of management, the board of directors and its committees. 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.

b. 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.

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 plan

a. The work plan is annual.

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

The guiding principle behind the annual work plan 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 plan.

The considerations taken into account in the compilation of the work plan 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**

Internal auditor, management, CEO, board's audit committee, chairman of the board of directors.

d. **Entity accepting and approving the work plan**

The board's audit committee

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

The auditor may propose subjects at her discretion or at the request of the CEO, and she may also recommend reducing or halting an examination of a topic approved in the work plan. 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 audit unit does not include an 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 internal audit procedure, and at her discretion, 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.

8.6 Scope of employment

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

The audit's work plan for 2008 included 10,800 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**

In accordance with the audit procedure, the internal auditor submitted to the audit committee the number of audit hours required for implementation of the annual work plan which derives from the multi-annual plan. The audit committee approved the work plan for 2009, the scope of which allowed for a reduction in the number of audit hours to 9,000 hours as well as a reduction in the number of employees by one internal auditor.

8.7 Preparation of the audit

a. **Work standards**

Bezeq'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 December 2004 an external audit investigation of Bezeq's internal audit unit 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 unit complies with accepted professional internal audit standards.

8.8 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.

8.9 Internal Auditor's report

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

The internal auditor routinely submits the audit reports during the reporting year to the board chairman, CEO, audit committee chairman and committee members. The board's audit committee conducts regular discussions of the audit reports. Following are the dates for submission of the auditor's reports and the dates for discussion by the audit committee in the reporting year:

No.	Report publication date	Audit committee discussion date
1	January 2007	January 2008
2	March 2007	January 2008
3	March 2007	January 2008
4	March 2007	January 2008
5	December 2007	January 2008
6	December 2007	February 2008
7	November 2007	February 2008
8	August 2007	March 2008
9	October 2007	March 2008
10	November 2007	March 2008
11	November 2007	March 2008
12	February 2008	May 2008

No.	Report publication date	Audit committee discussion date
13	February 2008	May 2008
14	January 2008	May 2008
15	May 2008	May 2008
16	January 2008	June 2008
17	February 2008	June 2008
18	January 2008	June 2008
19	May 2008	October 2008
20	July 2008	October 2008
21	July 2008	October 2008
22	July 2008	October 2008
23	September 2008	December 2008
24	December 2008	December 2008
25	December 2008	December 2008
26	December 2008	January 2009
27	December 2008	January 2009
28	December 2008	January 2009

In addition, the audit prepared a survey on the risks of embezzlement and fraud which was delivered in October 2008 and discussed by the audit committee in December 2007.

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

Based on sections 8.1 – 8.9 above and the reports received from the internal auditor, the members of the Company's board of directors believe, based on the reports received from the Company's auditor, that that the scope of the Company audit performed in 2008, the nature and continuity of the internal auditor's activities as well as the work plan, are reasonable in the circumstances and they achieve the objectives of the audit.

8.11 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 have been discussed and approved by the audit committee and board of directors as follows: Monthly salary of NIS 40,000 linked to the CPI and annual target-based bonus determined in advance by the audit committee and approved by the board of directors, of up to 50% of the annual salary without related expenses.

b. As set forth in section (8.1)(e) above, the internal auditor holds Company share options that were allocated to her as a Company employee.

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

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 property, plant and equipment serve to determine the depreciation expenses that will be recorded in the reporting year. The main part of the communications 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, such changes can have a material effect on the results of the actions and the financial position of the Group.

Assessing the value of items of property, plant and equipment

Certain property plant and equipment items 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. 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 determined on the basis of the Company's assessment. 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 turnover rates.
(Concerning changes in estimates due to these liabilities, 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 in extremely significant amounts are pending against Group companies.

Every year the Company makes 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 provisions and contingent liabilities, see Notes 15 and 17 to the financial statements.

Provision for doubtful 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 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. 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 on the grant date, the exercise price, weighted average of expected useful life of the option warrant, volatility of the share price and 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 their 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 31 to the financial statements).

Inventory

Inventory is measured as the lower of the cost and net sale value. The net sale value is an estimate that could be affected by various events and uncertainties. (See Note 3J to the financial statements.)

10. Disclosure regarding the proceeding for approving the Company's financial statements

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

a. Most of the committee members will 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 effect on the Company, it will discuss issues that arising 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 of substantial scope arises 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, Yoav Rubinstein, Elon Shalev, Arieh Saban, Ran Gottfried, Zehavit Cohen, Yiyzhak Idelman, Adam Chesnoff, Kihara R. Kiarie, David Gilboa, Rami Nomkin and Yehuda Porat, In addition, the following officers attended: Abraham Gabbay – CEO, Alan Gelman – CFO and Deputy CEO, Amir Nachlieli – General Counsel. Representatives of Somekh Chaikin, the Company's auditing accountants, also participated in the discussion.

11. Disclosure concerning the fees of the auditing accountant

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

Company	Auditor	Details	2008 (NIS '000)		2007 (NIS '000)	
			Fee	Hours	Fee	Hours
Bezeq	Somekh Chaikin	Audit	2,107	9,800	1,785	9,000
		Other services	716	2,610	452	1,475
Pelephone	Somekh Chaikin	Audit	800	3,950	650	4,200
		Other services	279	870	43	152
DBS	Kesselman & Kesselman (2007) and Somekh Chaikin (2007 – 2008)		545 [2]	2,500	621	4,300 [1]
Bezeq International	Somekh Chaikin	Audit	472	2,250	485	2,310
		Other services	24	110	124	590

The auditors' fee was discussed by the board's audit committee and approved by the Company's board. The fees were determined in relation to the hours and hourly tariff in the previous year and with adaptation to the changes and events which occurred in the reporting year.

(1) The audit hours in 2007 in DBS included overlapping between the auditors and the hours stemming from the Company's first audit.

(2) Including NIS 135,000 approved in 2008 for an addition to the 2007 audit.

12. Details of series of liability certificates

1.

		Series 4 debentures	Series 5 debentures
A	Issue date	01.06.2004	01.06.2004
B	Total par value on issue date	1,200,000,000 NIS	600,000,000 NIS
C	Par value	900,000,000 NIS	2,386,967,000 NIS (1)
D	Par value reassessed for report date (linked to the CPI)	990,959,163 NIS	2,628,207,579 NIS (2)
E	Accumulated interest	27,746,857 NIS	81,255,418 NIS
F	Fair value	1,031,400,000 NIS	2,866,747,367 NIS
G	Stock exchange value	1,031,400,000 NIS	2,866,747,367 NIS
H	Interest type	Fixed at 4.8%	Fixed at 5.3%
I	Principal payment dates	June 1 every year until 1.6.2011	June 1 every year from 1.6.2011 until 1.6.2016
J	Interest payment dates	June 1 every year until 1.6.2011	June 1 every year from 1.6.2011 until 1.6.2016
K	Linkage	The principal and interest are linked to the CPI (base index April 2004)	The principal and interest are linked to the CPI (base index April 2004)

(1) Of which NIS 880.1 million par value held by a wholly-owned subsidiary.
(2) Of which NIS 969 million held by a wholly-owned subsidiary.

Trust company – Mizrachi Tefahot Trust Company
The contact person in the trust company is Assaf Weiss, Adv. His email address is: assafw@umtb.co.il . The trustee's address is 123 Hahashmonaim Street, Tel Aviv.

2.

Rating agency	Rating	Rating changes	Rated credit type
Standard & Poor's Maalot	AA+	August 25, 2008 – the rating of the Company was raised from AA to AA+ with a stable outlook. The rating increase was based mainly on the Group's improvement in performance and operational efficiency, stability of the Company's management structure and a change in the business risk structure resulting from a change in the Group's revenue mix. October 13, 2008 – validation of the same rating and this was, inter alia, after an examination of the expected ramifications of the exercise of the purchase option (10.66%) exercised by Ap.Sb Ar.	All debenture series
Midroog	AA1	May 21, 2008 – restoration of the Company's rating outlook from negative to stable in view of an improvement in the Company's financial results and continued presentation of a strong financial profile, compensation for the erosion in the fixed-line domestic communications segment by means of operations in the other segments and very low levels of financing, despite a distribution of all the year's profit as a dividend after sale of the Company's controlling interest.	Debentures Series 4 and 5

The rating reports are attached in an appendix.

3. During and at the end of the reporting year the Company has met all the conditions and commitments pursuant to the deed of trust and there have been no conditions constituting cause to present the certificates of liability for early repayment. No collateral has been given to secure payment for the holders of the certificates of liability. There is no encumbrance whatsoever on the certificates of liability.

13. Miscellaneous

A. In October 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 prepared 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. As at the end of 2008 the code of ethics has been assimilated by the Company's managers. As of 2009 it is being assimilated by the Company's employees as part of the management routine.

B. 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.

C. As the challenges facing the global economic environment have translated into a slowdown in the Israeli economy, Bezeq is monitoring the potential impacts on its business on an ongoing basis. Despite this challenging economic backdrop, in 2009 we aim to maintain EBITDA, operating cash flows and gross capital expenditures close to those of full year 2008 performance levels. This forecast is underpinned by the strength of Bezeq's comprehensive consumer and business communications offerings, a strict focus on improving operating efficiencies and strong operating cash flows. With specific regards to gross capital

expenditures, 2009 will reflect continuing investment in Pelephone's HSPA network investment, which was successfully launched with national coverage at the end of January 2009, and the modular deployment of Bezeq's Next Generation Network (NGN), expanding its coverage to reach a meaningful part of Israeli households during 2010.

The information contained in this section includes forward-looking information which is based on the Company's assessments. The actual results are likely to be materially different from the above assessments, bearing in mind the changes that will occur in business conditions and due to the effects of regulatory decisions.

D. As at December 31, 2008 the scope of the Group's net contractual liabilities (including off balance sheet and less the scope of the hedging transactions) which are linked to the dollar amounted to NIS 836 million and the scope of the Group's net liabilities (including off balance sheet and less the scope of the hedging transactions) which are linked to the CPI amounted to NIS 5,064 million. The dollar exchange rate rose by 5.8% between December 31, 2008 and the date of signing the financial statements and the known CPI declined by 0.7% in December, January, and February 2009.

E. The Company is exposed to changes in the prices of copper which cause changes in the residual value of the Company's copper cable infrastructure. For further details, see Note 9(B) to the financial statements.

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

Shlomo Rodav Chairman of the Board of Directors	Abraham Gabbay CEO