BOS BETTER ONLINE SOLUTIONS LTD
Form 6-K
March 29, 2012

FORM 6 - K

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Report of Foreign Issuer

Pursuant to Rule 13a - 16 or 15d -16
of the Securities Exchange Act of 1934

For the Month of March 2012

B.O.S. Better Online Solutions Ltd.
(Translation of Registrant's Name into English)

20 Freiman Street, Rishon LeZion, 75100, Israel
(Address of Principal Corporate Offices)

Indicate by check mark whether the registrant files or will file annual reports under cover Form 20-F or Form 40-F.

Form 20-F S Form 40-F £

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b) (1): ____________

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b) (7): ____________

Indicate by check mark whether the registrant by furnishing the information contained in this form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes £ No S

If "Yes" is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): N/A

The Financial Statements and the consents attached to this Form 6-K are hereby incorporated by reference into all effective registration statements filed by us under the Securities Act of 1933, to the extent not superseded by documents or reports subsequently filed or furnished.

Attached hereto and incorporated by reference are:

1. The Consolidated Financial Statements of the Registrant as of December 31, 2011.

2. Consent of Kost Forer Gabbay & Kasierer, a member of Ernst & Young Global.

3. Consent of Arik Eshel, CPA & ASSOC., PC.

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

| | | |
|---|---|---|
| | B.O.S. Better Online Solutions Ltd.<br>(Registrant) | |
| Dated: March 29, 2012 | By: | /s/ Eyal Cohen<br>Eyal Cohen<br>CFO |

B.O.S. BETTER ONLINE SOLUTIONS LTD.

AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2011

IN U.S. DOLLARS

INDEX

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of

B.O.S. BETTER ONLINE SOLUTIONS LTD.

We have audited the accompanying consolidated balance sheets of B.O.S Better Online Solutions Ltd. ("the Company") and subsidiaries as of December 31, 2011 and 2010, and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2011. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the 2009 financial statements of BOS - Supply Chain Solutions (Lynk) Inc., a wholly-owned U.S. subsidiary, which statements reflected total assets constituting 19% of the consolidated totals as of December 31, 2009 and total revenues constituting 0% of the related consolidated totals for 2009. These statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for BOS - Supply Chain Solutions (Lynk) Inc., is based solely on the report of the other auditors.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management and evaluating the overall financial statement presentation. We believe that our audit and the report of the other auditors (for the year ended December 31, 2009), provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of other auditors (for the year ended December 31, 2009),, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and subsidiaries at December 31, 2011 and 2010, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2011, in conformity with U.S. generally accepted accounting principles.

KOST FORER GABBAY &
KASIERER
A Member of Ernst & Young Global

Tel-Aviv, Israel
March 29 , 2012

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ARIK ESHEL, CPA & ASSOC., PC
Certified Public Accountants and Consultants

Report of Independent Registered Public Accounting Firm

To the Board of Directors and
Stockholders of BOS - Supply Chain Solutions (Lynk) Inc.

We have audited the consolidated statements of income, stockholders' equity (deficit), and cash flows of BOS - Supply Chain Solutions (Lynk) Inc. ("the Company") and subsidiaries for the year ended December 31, 2009. The Company's management is responsible for these financial statements. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the results of operations of BOS- Supply Chain Solutions (Lynk) Inc. and subsidiaries for the year in the period ended December 31, 2009 in conformity with accounting principles generally accepted in the United States of America.

ARIK ESHEL, CPA & ASSOC., PC

New York, NY

March 29, 2012

B.O.S. BETTER ONLINE SOLUTIONS LTD.
AND ITS SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

| | December 31, 2011 | December 31, 2010 |
|---|---|---|
| ASSETS | | |
| | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | $411 | $703 |
| Trade receivables (net of allowance for doubtful accounts of $ 115 and $ 44 at December 31, 2011 and 2010, respectively) | 8,507 | 7,884 |
| | | |
| Other accounts receivable and prepaid expenses (Note 3) | 744 | 1,183 |
| Inventories (Note 5) | 4,020 | 5,125 |
| | | |
| Total current assets | 13,682 | 14,895 |
| | | |
| LONG-TERM ASSETS: | | |
| Severance pay fund | 41 | 47 |
| Bank deposits | 427 | - |
| Investment in other company (Note 6) | 68 | 107 |
| Other assets | 23 | 161 |
| | | |
| Total long-term assets | 559 | 315 |
| | | |
| PROPERTY, PLANT AND EQUIPMENT, NET (Note 7) | 1,166 | 1,135 |
| | | |
| OTHER INTANGIBLE ASSETS, NET (Note 8) | 540 | 1,512 |
| | | |
| GOODWILL (Note 9) | 4,122 | 4,438 |
| | | |
| | $20,069 | $22,295 |

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

B.O.S. BETTER ONLINE SOLUTIONS LTD.
AND ITS SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

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

| | December 31, 2011 | December 31, 2010 |
|---|---|---|
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Short-term bank loans and current maturities (Note 10) | $7,496 | $7,778 |
| Trade payables | 4,165 | 4,317 |
| Employees and payroll accruals | 553 | 735 |
| Deferred revenues | 550 | 639 |
| Accrued expenses and other liabilities (Note 11) | 994 | 1,040 |
| Total current liabilities | 13,758 | 14,509 |
| LONG-TERM LIABILITIES: | | |
| Long-term bank loans, net of current maturities (Note 12) | 1,530 | 394 |
| Income tax accruals (Note 16) | 273 | 488 |
| Accrued severance pay | 163 | 167 |
| Convertible note (Note 13) | - | 2,460 |
| Liability to Dimex Systems (Note 13) | 747 | 564 |
| Total long-term liabilities | 2,713 | 4,073 |
| COMMITMENTS AND CONTINGENT LIABILITIES (Note 14) | | |
| SHAREHOLDERS' EQUITY (Note 15) (*): | | |
| Share capital: | | |
| Ordinary shares of NIS 20.00 nominal value: Authorized; 10,000,000 and 7,000,000 shares at December 31, 2011 and 2010; Issued and outstanding: 4,467,924 and 2,752,517 shares at December 31, 2011 and 2010, respectively | 23,065 | 13,959 |
| Additional paid-in capital | 51,093 | 56,805 |
| Accumulated other comprehensive profit (loss) | (243) | 52 |
| Accumulated deficit | (70,317) | (67,103) |
| Total shareholders' equity | 3,598 | 3,713 |
| Total liabilities and shareholders' equity | $20,069 | $22,295 |

| | |
|---|---|
| /s/ Yuval Viner | /s/ Eyal Cohen |
| Yuval Viner | Eyal Cohen |
| Chief Executive Officer | Chief Financial Officer |

(*) All share data are reported after the effect of the 1 for 5 reverse split that occurred on January 12, 2010.

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

B.O.S. BETTER ONLINE SOLUTIONS LTD.
AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

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

| | Year ended December 31, | | |
|---|---|---|---|
| | 2011 | 2010 | 2009 |
| Revenues | $33,434 | $30,187 | $25,467 |
| Cost of revenues | 26,481 | 22,668 | 19,741 |
| Inventory write offs | 443 | 36 | 2,235 |
| Gross profit | 6,510 | 7,483 | 3,491 |
| Operating costs and expenses: | | | |
| Research and development, net | 403 | 372 | 360 |
| Sales and marketing | 4,273 | 4,068 | 5,426 |
| General and administrative | 2,252 | 1,786 | 2,004 |
| Impairment of goodwill and other intangible assets (Notes 8, 9) | 555 | - | 383 |
| Total operating costs and expenses | 7,483 | 6,226 | 8,173 |
| Operating Profit (loss) | (973) | 1,257 | (4,682) |
| Financial expenses, net (Note 17a) | (2,241) | (961) | (606) |
| Other expenses, net (Note 2g) | (172) | (120) | (409) |
| Income (loss) before taxes on income | (3,386) | 176 | (5,697) |
| Tax benefit (taxes on income) (Note 16) | 172 | (5) | (329) |
| Income (loss) from continuing operations | (3,214) | 171 | (6,026) |
| Loss from discontinued operations (Note 1e) | - | (806) | (3,075) |
| Net loss | $(3,214) | $(635) | $(9,101) |
| Basic and diluted net earnings (loss) per share from continuing operations (Note 17b) (*) | $(1.14) | $0.07 | $(2.32) |
| Basic and diluted net loss per share from discontinued operations (Note 17b) (*) | $- | $(0.31) | $(1.18) |
| Basic and diluted net loss per share (Note 17b) (*) | $(1.14) | $(0.24) | $(3.50) |

(*) All earnings (loss) per share data are reported after the effect of the 1 for 5 reverse split that occurred on January 12, 2010.

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

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B.O.S. BETTER ONLINE SOLUTIONS LTD.
AND ITS SUBSIDIARIES

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

U.S. dollars in thousands, except share data

| | Ordinary shares (*) | Share capital | Additional paid-in capital | Accumulated other comprehensive income (loss) (**) | Accumulated deficit | Total comprehensive loss | Total shareholders' equity |
|---|---|---|---|---|---|---|---|
| Balance at January 1, 2009 | 2,605,592 | $ 13,159 | $ 55,830 | $ (378 ) | $ (57,367 ) | | $ 11,244 |
| Issuance of Ordinary shares for options exercised | 12,567 | 66 | (66 ) | - | - | | - |
| Issuance expenses | - | - | (17 ) | - | - | | (17 ) |
| Issuance of warrants related to convertible note | - | - | 646 | - | - | | 646 |
| Share-based compensation expense | - | - | 649 | - | - | | 649 |
| Other comprehensive loss: | | | | | | | |
| Foreign currency translation adjustments | - | - | - | 168 | - | $ 168 | 168 |
| Unrealized gain related to available for sale securities | | | | 54 | - | 54 | 54 |
| Net loss | - | - | - | - | (9,101 ) | (9,101 ) | (9,101 ) |
| Total comprehensive loss | | | | | | $ (8,879 ) | |
| Balance at December 31, 2009 | 2,618,159 | 13,225 | 57,042 | (156 ) | (66,468 ) | | 3,643 |
| Issuance of Ordinary shares for options | 37,996 | 201 | (201 ) | - | - | | - |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| exercised | | | | | | | |
| Issuance of shares related to the private placement (net of $35 issuance expenses) | 96,362 | 533 | (268 ) | - | - | | 265 |
| Issuance of warrants related to convertible note | - | - | 15 | - | - | | 15 |
| Share-based compensation expense | - | - | 217 | - | - | | 217 |
| Other comprehensive loss: | | | | | | | |
| Foreign currency translation adjustments | - | - | - | 262 | - | $ 262 | 262 |
| Realized gain related to available for sale securities | | | | (54 ) | - | (54 ) | (54 ) |
| Net loss | - | - | - | - | (635 ) | (635 ) | (635 ) |
| Total comprehensive loss | | | | | | $ (427 ) | |
| | | | | | | | |
| Balance at December 31, 2010 | 2,752,517 | 13,959 | 56,805 | 52 | (67,103 ) | - | 3,713 |
| Issuance of Ordinary shares for options exercised | 33,442 | 195 | (195 ) | - | - | - | - |
| Issuance of Ordinary shares related to an inducement of a convertible note | 1,681,965 | 8,911 | (5,772 ) | - | - | - | 3,139 |
| Extension of warrants related to convertible note | - | - | 86 | - | - | - | 86 |
| Share-based compensation expense | - | - | 169 | - | - | - | 169 |
| Other comprehensive | | | | | | | |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| loss: | | | | | | | |
| Foreign currency translation adjustments | - | - | - | (295 ) | - | $ (295 ) | (295 ) |
| Net loss | - | - | - | - | (3,214 ) | (3,214 ) | (3,214 ) |
| Total comprehensive loss | - | - | - | | - | $ (3,509 ) | |
| | | | | | | | |
| Balance at December 31, 2011 | 4,467,924 | $ 23,065 | $ 51,093 | $ (243 ) | $ (70,317 ) | | $ 3,598 |

(*) All share data are reported after the effect of the 1 for 5 reverse split that occurred on January 12, 2010.

(**) December 31, 2009 balance includes both foreign currency translation adjustments and unrealized gains related to available for sale securities. December 31, 2010 and December 31, 2011 balance includes only foreign currency translation adjustments.

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

B.O.S. BETTER ONLINE SOLUTIONS LTD.
AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

| | Year ended December 31, | | |
|---|---|---|---|
| | 2011 | 2010 | 2009 |
| Cash flows from operating activities: | | | |
| Net loss | $(3,214) | $(635) | $(9,101) |
| Loss from discontinued operations | - | 806 | 3,075 |
| | | | |
| Net profit (loss) from continuing operations | (3,214) | 171 | (6,026) |
| | | | |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: | | | |
| Depreciation and amortization | 656 | 611 | 596 |
| Inventory write off | 443 | 36 | 2,235 |
| Impairment of goodwill and intangible assets | 555 | - | 383 |
| Capital loss from sale of investment in other company | - | 7 | - |
| Impairment of available for sale securities | 156 | - | 304 |
| Impairment of investment in other company | 39 | 111 | 53 |
| Severance pay, net | 5 | - | (160) |
| Share-based compensation expenses related to employees, directors and service providers | 169 | 217 | 649 |
| Amortization of discount on convertible note | 202 | 225 | 108 |
| Accrued interest on long-term convertible notes | 230 | 196 | 104 |
| Inducement expenses of convertible note | 760 | - | - |
| Revaluation of fair value related to extension of warrants as part of an Inducement of a convertible note | 86 | | |
| Decrease (increase) in trade receivables, net | (1,045) | (417) | 2,897 |
| Change in income tax accruals | (199) | 52 | 343 |
| Decrease (increase) in other accounts receivable and other assets | 363 | (114) | (155) |
| Decrease (increase) in inventories | 506 | 138 | (66) |
| Increase (decrease) in trade payables | (46) | 332 | (818) |
| Decrease in employees and payroll accruals, deferred revenues, accrued expenses and other liabilities | (31) | (105) | (426) |
| | | | |
| Net cash provided by (used in) operating activities from continuing operations | (365) | 1,460 | 21 |
| Net cash used in operating activities from discontinued operations | - | (176) | (1,291) |
| | | | |
| Net cash provided by (used in) operating activities | (365) | 1,284 | (1,270) |
| | | | |
| Cash flows from investing activities: | | | |
| Purchase of property, plant and equipment | (357) | (108) | (320) |
| Change in long term bank deposits | (427) | - | - |
| Proceeds from sale of investment in other company | - | 150 | - |

| | | | |
|---|---|---|---|
| Repayment of deferred consideration for the acquisition of Dimex Systems Ltd activity | (256) | (147) | (967) |
| | | | |
| Net cash used in investing activities from continuing operations | (1,040) | (105) | (1,287) |
| Net cash used in investing activities from discontinued operations | - | - | (74) |
| | | | |
| Net cash used in investing activities | (1,040) | (105) | (1,361) |
| | | | |
| Cash flows from financing activities: | | | |
| Proceeds from issuance of shares, net | - | 265 | (17) |
| Proceeds from (repayment of) short and long-term bank loans | 1,113 | (841) | (363) |
| Proceeds from (repayment of) long-term convertible note and warrants, net of issuance expenses | - | (28) | 1,584 |
| | | | |
| Net cash provided by (used in) financing activities from continuing operations | 1,113 | (604) | 1,204 |
| Net cash provided by (used in) financing activities from discontinued operations | - | (308) | 385 |
| | | | |
| Net cash provided by (used in) financing activities | 1,113 | (912) | 1,589 |
| | | | |
| Increase (decrease) in cash and cash equivalents | (292) | 267 | (1,042) |
| Increase (decrease) in cash and cash equivalents from discontinued operations | - | (128) | 359 |
| Cash and cash equivalents at the beginning of the year | 703 | 564 | 1,247 |
| | | | |
| Cash and cash equivalents at the end of the year | $411 | $703 | $564 |

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

B.O.S. BETTER ONLINE SOLUTIONS LTD.
AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

| | Year ended December 31, | | |
|---|---|---|---|
| | 2011 | 2010 | 2009 |
| Supplemental disclosure of cash flow activities: | | | |
| (i) Net cash paid during the year for: | | | |
| Interest | $ 572 | $ 463 | $ 538 |
| Income tax | $ 2 | $ 2 | $ 1 |
| (ii) Non-cash activities: | | | |
| Conversion of payable into long-term convertible debentures | $ - | $ 161 | $ 675 |
| Deferred charges related to convertible note | $ - | $ - | $ 62 |
| Sale of investment in other company | $ - | $ 150 | $ - |
| Purchase of property and equipment | $ - | $ - | $ 47 |
| Inducement of a convertible note into share capital | $ 2,523 | $ - | $ - |

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1:- GENERAL

a. B.O.S. Better Online Solutions Ltd. ("BOS" or "the Company") is an Israeli corporation.

The Company's shares are listed on NASDAQ under the ticker BOSC. Effective as of May 12, 2009, the Company's ordinary shares were delisted from trade on the Tel-Aviv Stock Exchange ("TASE"). Following the delisting of the Company's shares from the TASE, the Company is not subject to reporting requirements in Israel, under the Israeli Securities Law.

On January 17, 2012, the Company received a notice from the Listing Qualifications Department of The Nasdaq Stock Market (“Nasdaq”) advising the Company that it has failed to comply with Nasdaq’s requirement that listed securities maintain a minimum bid price of $1.00 per share as set forth in Nasdaq Listing Rules (see Note 20a)

b. In the year ended December 31, 2011, the Company incurred a loss of $3,214 and generated negative cash flow from current operations amounting to $365. Due to the above, the Company's cash and cash equivalent decreased from $703 as of December 31, 2010 to $411 as of December 31, 2011. In addition, long-term bank loans increased by $1,136 during fiscal year 2011.In view of the above, the Company has implemented an overall efficiency plan, including: a conversion of the convertible note as described in note 13 and a reduction in workforce. The Company expects to meet its bank covenants through December 31, 2012 and believes that its cash resources are sufficient to meet its operating needs for at least the next 12 months.

c. All share and per share data in this report is reported after giving effect to the 1 for 5 reverse split that occurred on January 12, 2010 (see Note 15).

d. The Company has two operating segments: the RFID and Mobile Solutions segment and the Supply Chain Solutions segment (see Note 18).

The Company's wholly-owned subsidiaries include:

In Israel:

(1) BOS-Dimex Ltd. (previously "Dimex Solutions Ltd"), an Israeli company that provides comprehensive turn-key solutions for Automatic Identification and Data Collection.

BOS-Dimex Ltd. purchased in March 2008 all of the assets and activities of Dimex Systems Ltd.; and its wholly-owned subsidiary, Dimex Hagalil Projects (2008) Ltd., which was incorporated in January 2008, purchased all of the assets and activities of Dimex Hagalil Ltd. ; and

(2) BOS-Odem Ltd. ("BOS-Odem"), an Israeli company, is a distributor of electronics components and advance technologies worldwide. BOS-Odem is a part of the Supply Chain Solutions segments; and

(3) Quasar Telecom (2004) Ltd. ("Quasar Telecom"), which is inactive.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1:- GENERAL

In the United States:

(1) Ruby-Tech Inc., a New York corporation, a wholly-owned subsidiary of BOS-Odem and a part of the Supply Chain Solutions segments;

(2) BOS - Supply Chain Solutions (Lynk) Inc., a Delaware Corporation ("Lynk"), and its subsidiaries BOS-Supply Chain Solutions Inc. (Summit) Ltd. ("Summit"), Pacific Information Systems, Inc. ("PacInfo"), a Delaware corporation and PacInfo's subsidiary Dean Tech Technologies Associates, LLC., a Texan corporation ("Dean Tech"). Both of Pacinfo and Dean Tech are no longer active. On November 23, 2010 the Company announced that its two U.S. subsidiaries that are part of its Supply Chain division, Lynk and its subsidiary Summit, have filed with the US Bankruptcy Court a Chapter 7 petition. Lynk's case was closed on March 4, 2011.

(3) BOS Delaware Inc., a Delaware corporation, which ceased operations in 2002.

In Europe:

BOS-Dimex has a UK subsidiary, Better On-Line Solutions Ltd. Since 2002, this company and its subsidiary, Better On-Line Solutions S.A.S that is incorporated in France, are not active.

In addition, the Company holds shares in two other companies:

(1) Surf Communication Systems Ltd. ("Surf") that is a developer and global supplier of universal access and network convergence software solutions to the wire line and wireless telecommunications and data communications industries. As of December 31, 2011, the Company holds 6.2% of the outstanding shares of Surf (see Note 2f).

(2) New World Brands Inc. (OTCQB: NWBD) ("NWB"), a U.S. public corporation. The Company's holdings in NWB were received as the consideration for the sale of the Company's communication segment. As of September 30, 2010 (the last time NWB filled a financial report), the Company holds 12.8% of the outstanding shares of NWB (see Note 2f).

e. Discontinued operations:

The results of operations, including revenues, cost of revenues, operating expenses, and other income and expenses related to the prior periods of the discontinued operations, have been reclassified in the accompanying statements of operations as discontinued operations.

1. In February 2009, the Company sold its OptimizeIT product and related Intellectual Property (following the Company's decision in December 2008 to cease the operation of this product line) in consideration for $ 70 plus contingent royalties amounting to 7.5% of future revenues until the earlier of: (i) payment of $ 1,500 or (ii) the lapse of forty-two months from February 2009. As of December 31, 2011, no income from royalties was recorded.

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B.O.S. BETTER ONLINE SOLUTIONS LTD.
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1:- GENERAL (Cont.)

2. On November 23, 2010 the Company announced that its two U.S. subsidiaries that are part of its Supply Chain division, Lynk and its subsidiary Summit, have filed with the US Bankruptcy Court a Chapter 7 petition.

Summarized selected financial information of the discontinued operations are as follows:

| | Year ended December 31, 2011 | 2010 | 2009 |
|---|---|---|---|
| Revenues | $ - | $ 8,338 | $ 8,615 |
| Cost of revenues | - | 6,990 | 7,704 |
| | | | |
| Gross profit | - | 1,348 | 911 |
| | | | |
| Impairment of goodwill | | - | 835 |
| Total operating costs and expenses | - | 1,487 | 2,705 |
| | | | |
| Operating loss | - | (139) | (2,629) |
| Financial expenses, net | - | (213) | (232) |
| Other expenses, net (*) | - | (496) | - |
| | | | |
| Loss before taxes on income | - | (848) | (2,861) |
| Tax benefit (taxes on income) | - | 42 | (214) |
| | | | |
| Net loss | $ - | $ (806) | $ (3,075) |

(*) Other expenses include $ 554 related to the write off of net assets and liabilities related to discontinued operations.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements are prepared according to United States generally accepted accounting principles ("U.S. GAAP").

a. Use of estimates:

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. The most significant assumptions are employed in estimates used in determining values of goodwill and identifiable intangible assets, provision for inventory, revenue recognition, tax assets and tax positions, legal contingencies, stock-based compensation costs, and assumptions utilized in troubled debt restructuring. Actual results could differ from those estimates.

b. Financial statements in U.S. dollars:

A substantial portion of the Company's revenues is generated in U.S. dollar ("dollars"). In addition, most of the Company's costs are incurred in dollars. Company's management believes that the dollar is the primary currency of the economic environment in which the Company operates. Thus, the functional and reporting currency of the Company is the dollar. Accordingly, monetary accounts maintained in currencies other than the dollar are remeasured into U.S. dollars in accordance with ASC 830, Foreign Currency Matters. All transactions gains and losses from the remeasurement of monetary balance sheet items are reflected in the statement of operations as financial income or expenses as appropriate.

The financial statements of a certain subsidiary, whose functional currency is other than the dollar, have been translated into U.S. dollars. All balance sheet accounts have been translated using the exchange rates in effect at the balance sheet date. Statement of operations amounts have been translated using the average exchange rate for the period. The resulting translation adjustments are reported as a component of shareholders' equity in accumulated other comprehensive loss.

c. Principles of consolidation:

The consolidated financial statements include the accounts of the Company and its subsidiaries. Intercompany transactions and balances including profits from intercompany sales not yet realized outside the Company have been eliminated upon consolidation.

d. Cash equivalents:

Cash equivalents are short-term highly liquid investments that are readily convertible to cash purchased with original maturities of less than three months.

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NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

e. Inventories:

Inventories are valued at the lower of cost or market value. Cost is determined using the moving average cost method.

Inventory write-offs and write-downs are provided to cover risks arising from slow-moving items or technological obsolescence. During 2011, 2010 and 2009, inventory write-offs of $ 443, $ 36 and $ 2,235, respectively, have been recorded and presented in the consolidated statements of operations.

f. Investment in other companies:

1. Investment in NWB and QMX:

The Company accounts for its holdings in NWB shares as available for sale in accordance with ASC 320, Investments - Debt And Equity Securities ("ASC 320"). Unrealized gains and losses, net of the related tax effect are included in other comprehensive loss. In January 2009, Qualmax was merger with and into NWB , and holdings in Qualmax were converted into shares of NWB.

Prior to this merger, the investment in Qualmax, which was traded on the Pink Sheets, was presented at cost according to ASC 325-20, Cost Method Investments ("ASC 325-20") due to no trading volume in the Qualmax shares.

Management evaluates investments in other companies for evidence of other-than- temporary declines in value. The Company recognizes an impairment charge when a decline in the fair value of its marketable securities below the cost basis is presumed to be other-than-temporary. The Company considers various factors in determining whether to recognize an impairment charge, including the Company's intent and ability to hold the marketable securities for a period of time sufficient to allow for any anticipated recovery in market value, the length of time and extent to which the fair value has been less than the cost basis and the financial condition and near-term prospects of the issuers. If, after consideration of all available evidence to evaluate the realizable value of its marketable securities, impairment is determined to be other than- temporary, then an impairment loss equal to the difference between the marketable securities' carrying amount and its fair value is recognized. Accordingly, during 2011, 2010 and 2009, an impairment loss, due to other-than-temporary decline in fair value, of $ 156, $ 0 and $ 304, respectively, has been recorded and presented in other expenses, net in the consolidated statements of operations.

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

On February 26, 2010, the Company sold all of its holdings in NWB to P&S Spirit LLC. and recorded a capital loss of $7. The Company sold 61,441,827 shares of common stock of NWB (the "Shares") and 1,430,178 warrants to purchase common stock of NWB at an exercise price of $ 0.2098 per share expiring on December 31, 2010 (the "Warrants"). The consideration for the Shares and Warrants was $ 300 of which $ 150 was paid in March 2010 and the remaining $ 150 plus annual interest of 4% were to be paid in twelve monthly installments commencing March 2011. The Shares and Warrants were delivered to an escrow agent, to be released to the Buyer upon full payment of the Remaining Debt. In May 2011, the buyer notified the Company that it will not pay the remaining debt, and the shares and warrants were released back to the Company. As of December 31, 2011 the Company recognized other-than-temporary loss of $156, reflecting that the investment in NWB was fully impaired.

2. Investment in Surf:

The Company's holding in Surf (a private company) as of December 31, 2011 is 6.2% of Surf's issued and outstanding shares. The Company's investment in Surf is accounted for based on the cost accounting method. During 2011, 2010 and 2009, an impairment loss, due to other-than- temporary decline in fair value, of $ 39, $ 111 and $ 53, respectively, has been recorded and presented in other expenses, net in the consolidated statements of operations.

The Company's investment in Surf is reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the investment may not be recoverable, in accordance with ASC 325-20.

g. Property, plant and equipment:

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

| | % | |
|---|---|---|
| Computers and software | 20 - 33 | (mainly 33%) |
| Office furniture and equipment | 6 - 15 | (mainly 10%) |
| Leasehold improvements | 10 | (over the shorter of the period of the lease or the life of the assets) |
| Motor vehicles | 15 | |
| Real estate | 4 | |

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

h. Impairment of long-lived assets:

The Company's long-lived assets are reviewed for impairment in accordance with ASC 360-10, Accounting for the Impairment or Disposal of Long-Lived Asset, whenever events or changes in circumstances indicate that the carrying amount of an asset (or asset group) may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset (or asset group) to the future undiscounted cash flows expected to be generated by the assets (or asset group). If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds their fair value of the assets. During 2011 the Company recognized an impairment loss of $555 related to a brand name and customer list. of which $470 were attributed to the Supply Chain segment and $85 were attributed to the RFID and Mobile solutions segment. The fair value of the brand name and customer list related intangibles was determined by the income approach method. Assumptions in the fair value assessment included: the impact of changes in economic conditions, revenue and cash flow forecasts for the remaining lives of the intangibles and the Company's weighted average cost of capital ("WACC").
During 2010 and 2009, no impairment losses have been identified.

i. Goodwill:

Goodwill represents excess of the costs over the net assets of businesses acquired. Under ASC 350, Intangibles - Goodwill and Other ("ASC 350"), goodwill is not amortized but instead is tested for impairment at least annually or between annual tests in certain circumstances, and written-down when impaired.

Testing Methodology:

The Company performs its annual impairment analysis of goodwill as of December 31 of each year, or more often if there are indicators of impairment present. The provisions of ASC 350 require that a two-step impairment test be performed on goodwill at the level of the reporting units. In the first step, or Step 1, the Company compares the fair value of each reporting unit to its carrying value. If the fair value exceeds the carrying value of the net assets, goodwill is considered not impaired, and the Company is not required to perform further testing. If the carrying value of the net assets exceeds the fair value, then the Company must perform the second step, or Step 2, of the impairment test in order to determine the implied fair value of goodwill. To determine the fair value used in Step 1, the Company uses discounted cash flows. If and when the Company is required to perform a Step 2 analysis, determining the fair value of its net assets and its off-balance sheet intangibles would require it to make judgments that involve the use of significant estimates and assumptions.

The reporting units of the Company for purposes of the impairment test are: the Company's RFID and Mobile solutions segment, and the Supply Chain segment, as these are the components of the business for which discrete financial information is available and the segment management regularly reviews the operating results of those components.

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

In order to determine the fair value used in Step 1, the Company uses discounted cash flows. If and when the Company is required to perform a Step 2 analysis, determining the fair value of its net assets and its off-balance sheet intangibles would require it to make judgments that involve the use of significant estimates and assumptions. The Company determined the fair value of each reporting unit using the Income Approach, which utilizes a discounted cash flow model, as it believes that this approach best approximates the reporting unit's fair value at this time. Judgments and assumptions related to revenue, operating income, future short-term and long-term growth rates, weighted average cost of capital, interest, capital expenditures, cash flows, and market conditions are inherent in developing the discounted cash flow model. The material assumptions used for the Income Approach for 2011 were five years of projected net cash flows, WACC of 15% and a long-term growth rate of 3%. The Company considered historical rates and current market conditions when determining the discount and growth rates to use in its analyses. If these estimates or their related assumptions change in the future, the Company may be required to record impairment charges for its goodwill.

The Company corroborates the fair values using the Market Approach. The Company evaluates the reasonableness of the estimated fair value of its reporting units by reconciling to its market capitalization. This reconciliation allows the Company to consider market expectations in corroborating the reasonableness of the fair value of its reporting units. In addition, the Company compares its market capitalization, including an estimated control premium that an investor would need to pay for a controlling interest in the Company, to the fair value of the Company based on a third-party valuation study. The determination of a control premium requires the use of judgment and is based primarily on comparable industry and deal-size transactions, related synergies and other benefits. The Company's reconciliation of the gap between its market capitalization and the aggregate fair value of the Company depends on various factors, some of which are qualitative and involve management judgment, including stable relatively high backlog coverage and experience in meeting operating cash flow targets.

Testing Results:

During 2011 and 2010, no impairment losses have been identified.

During 2009 impairment losses in the amount of $ 383 were recorded and attributed to the Supply Chain solutions reporting unit.

j. Research and development costs:

ASC 985, Software, requires capitalization of certain software development costs subsequent to the establishment of technological feasibility. Based on the Company's product development process, technological feasibility is established upon completion of a working model. Research and development costs incurred in the process of developing product improvements or new products, are generally charged to expenses as incurred. Costs incurred by the Company between completion of the working model and the point at which the product is ready for general releases are insignificant.

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NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

k. Severance pay:

The Company's liability for severance pay for some of the Israeli employees is calculated pursuant to the Israeli Severance Pay Law based on the most recent salary of the employees multiplied by the number of years of employment as of the balance sheet date. Employees are entitled to one month's salary for each year of employment or a portion thereof. The Company's liability for its Israeli employees is covered by insurance policies designed solely for distributing severance pay. The value of these policies is not under the Company's control, thus neither an asset nor a liability were recorded regarding these policies.

The Company has one general deposit fund. The value of the deposited funds includes profits, and is recorded as an asset in the Company's balance sheet.

The Company's payroll includes employees regarding whom its liability for severance pay is calculated pursuant to article 14 of Israel's Severance Pay Law. The Company currently deposits the corresponding amounts required in accordance with article 14 to the relevant pension funds. These amounts will be released to the applicable employees upon termination of employment and this substitutes the obligation described above, to pay severance based on the most recent salary of the employee multiplied by the number of years of employment. The aforementioned deposited amounts are not reflected on the financial statements due to the fact that they are not under the Company's control.

Severance expenses for 2011, 2010 and 2009 amounted to $ 242, $ 137 and $ 263, respectively.

l. Revenue recognition:

The Company derives its revenues from the sale of products, license fees for its products, commissions, support and services.

Revenues from product sales, related to both the Supply Chain and RFID and Mobile segments, are recognized in accordance with SAB 104, Revenue Recognition ("ASC 605") when delivery has occurred, persuasive evidence of an arrangement exists, the vendor's fee is fixed or determinable, no further obligation exists, and collectability is reasonably assured.

Most of the Company's revenues are generated from sales of its products directly to end-users. Other than pricing terms which may differ due to the volume of purchases between end-users, there are no material differences in the terms and arrangements among end-users.

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Revenue from license fees, related to the RFID and Mobile solutions segment, is recognized in accordance with ASC No. 985-605, Software Revenue Recognition, when persuasive evidence of an agreement exists, delivery has occurred, no significant obligations with regard to implementation remain, the fee is fixed or determinable, and collectability is probable. The Company generally does not grant a right of return to its customers. When a right of return exists, the Company defers revenue until the right of return expires, at which time revenue is recognized provided that all other revenue recognition criteria have been met.

Revenues from maintenance and support services related to the license are recognized ratably over the period of the support contract.

Starting January 1, 2011 the Company adopted the guidance of ASU 2009-13, Multiple-Deliverable Revenue Arrangements, (amendments to FASB ASC Topic 605, Revenue Recognition) ("ASU 2009-13"). ASU 2009-13 requires entities to allocate revenue in an arrangement using estimated selling prices of the delivered goods and services based on a selling price hierarchy. The amendment eliminates the residual method of revenue allocation and requires revenue to be allocated using the relative selling price method. As such, the Company prospectively applied these provisions to all revenue arrangements entered into or materially modified after January 1, 2011. This guidance does not generally change the units of accounting for the Company’s revenue transactions. Most products and services qualify as separate units of accounting and the revenue is recognized when the applicable revenue recognition criteria are met.

The Company's revenue recognition policies provide that, when a sales arrangement contains multiple elements, the Company allocates revenue to each element based on a selling price hierarchy. The selling price for a deliverable is based on its vendor specific objective evidence ("VSOE"), if available, third party evidence ("TPE") if VSOE is not available, or estimated selling price ("ESP") if neither VSOE nor TPE is available.

Because the Company has neither VSOE nor TPE for its deliverables, the allocation of revenue has been based on the Company’s BESP. Amounts allocated to the deliverables are recognized at the time of sale provided the other conditions for revenue recognition have been met.

The Company’s process for determining its BESP considers multiple factors that may vary depending upon the unique facts and circumstances related to each deliverable. A key factor considered by the Company in developing the BESP for its products is the gross margins acceptable in the industry in which the Company operates. The Company may also consider additional factors as appropriate.

The adoption of the amendment to ASC 605-25 did not have a material effect on the Company's consolidated financial position or results of operations.

In addition, in cases that product arrangement is bundled with a separately priced extended warranty that fall under the scope of ASC 605- 20-25-1 through 25-6, revenues from the extended warranty are deferred and recognized ratably over the extended warranty period.

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NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

In the case of arrangements which require significant customization of the Company's RFID software to customer-specific specifications, the Company follows the guidance in ASC 605-35, ("ASC 605-35"), whereby the Company applies the completed contract method, since the Company is unable to obtain reasonable dependable estimates of the total effort required for completion. Under the completed contract method, all revenue and related costs of revenue are deferred and recognized upon completion. Provisions for estimated losses on contracts in process are recognized in the period such losses are determined.

m. Income taxes:

The Company and its subsidiaries account for income taxes in accordance with ASC 740, Income Taxes ("ASC 740"). ASC 740 prescribes the use of the liability method whereby deferred tax assets and liability account balances are determined based on the differences between the financial reporting and the tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company and its subsidiaries provide a valuation allowance, if necessary, to reduce deferred tax assets to the amounts that are more likely-than-not to be realized.

The Company implements a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with ASC 740. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates it is- more- likely- than- not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount which is more than 50% likely of being realized upon ultimate settlement.. During the year ended December 31, 2011, the Company recorded tax income of $261 in regard to a decrease of uncertain tax position. During the years ended December 31, 2010 and 2009 the Company recorded tax expenses of $ 67 and $421, respectively in regard to uncertain tax positions.

n. Concentrations of credit risk:

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents, trade receivables and other accounts receivable.

The trade receivables of the Company are derived from sales to customers located primarily in Israel, America, the Far East and Europe. The Company generally does not require collateral; however most of the Company's customer outside of Israel are insured against customer nonpayment, through the Israeli Credit Insurance Company Ltd. In certain circumstances, the Company may require letters of credit, other collateral, additional guarantees or advanced payments. An allowance for doubtful accounts is determined with respect to specific debts that are doubtful of collection.

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

o. Derivative financial instruments:

The Company's Derivatives are not designated as hedging accounting instruments under ASC 815, Derivatives and Hedging (originally issued as SFAS 133 and SFAS161).

Those derivatives consist primarily of forward contracts the Company uses to hedge the Company's exposure to currencies other than the U.S. dollar. The Company recognized derivative instruments as either assets or liabilities and measures those instruments at fair value. The derivative instruments that the Company holds do not meet the definition of hedging instruments under ASC 815, Derivatives and Hedging (originally issued as SFAS 133 and SFAS161). Therefore, the Company recognizes changes in the fair values of the derivatives in its statement of income in financial income, net, at the same period as the remeasurement of gain and loss of the related foreign currency denominated assets and liabilities.

As of December 31, 2011, the notional principal of foreign exchange contracts to purchase U.S. dollars with foreign currencies and to sell Euros for foreign currencies was $ 1,600 and €280. The Company recorded the fair value of derivative liability in the amount of $ 67 in accrued expenses and other liabilities.

p. Basic and diluted net earnings (loss) per share:

Basic net earnings (loss) per share are calculated based on the weighted average number of ordinary shares outstanding during each year. Diluted net earnings (loss) per share are calculated based on the weighted average number of ordinary shares outstanding during each year, plus the potential dilution to ordinary shares considered outstanding during the year, in accordance with ASC 260, Earning per Share.

The total number of ordinary shares related to outstanding options and warrants that was excluded from the calculations of diluted net earnings (loss) per share, since they would have an anti-dilutive effect, was 1,524,610 , 1,442,339 and 1,333,370 for the years ended December 31, 2011 , 2010 and 2009, respectively.

q. Accounting for share-based compensation:

The Company accounts for equity-based compensation in accordance with ASC 718, Stock Compensation ("ASC 718") which requires the recognition of compensation expenses based on estimated fair values for all equity-based awards made to employees and nonemployees and directors.

ASC 718 requires companies to estimate the fair value of equity-based payment awards on the date of grant using an option pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as an expense over the requisite service periods in the Company's consolidated statements of operations.

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Company recognizes compensation expenses for the value of its awards granted based on the straight line method over the requisite service period of each of the awards, net of estimated forfeitures. ASC 718 requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Estimated forfeitures are based on actual historical pre-vesting forfeitures. The Company considers many factors when estimating forfeitures, including employee class and historical experience.

The Company estimates the fair value of stock options granted using the Black-Scholes options pricing model. The option-pricing model requires a number of assumptions, of which the most significant are expected stock price volatility and the expected option term. Expected volatility was calculated based upon actual historical stock price movements over the most recent periods ending on the date of grant, equal to the expected option terms. The expected option term represents the period that the Company's stock options are expected to be outstanding and was determined based on the simplified method permitted by SAB 107 and extended by SAB 110 as the average of the vesting period and the contractual term. The Company currently uses the simplified method as adequate historical experience is not available to provide a reasonable estimate. The Company adopted SAB 110 effective January 1, 2008 and will continue to apply the simplified method until enough historical experience is available to provide a reasonable estimate of the expected term for stock option grants. The risk-free interest rate is based on the yield from U.S. Treasury zero-coupon bonds with an equivalent term. The Company has historically not paid dividends and has no foreseeable plans to pay dividends.

The fair value for options granted in 2011 and 2009 was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

| | Year ended December 31, | |
|---|---|---|
| | 2011 | 2009 |
| Risk-free interest | 1.17% | 1.45% |
| Dividend yields | 0% | 0% |
| Volatility | 96% | 77% |
| Expected option term | 3.83 years | 3.46 years |
| Forfeiture rate | 24% | 15% |

No options were granted during 2010.

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

During 2011, 2010 and 2009, the Company recognized stock-based compensation expense related to employee and director stock options as follows:

| | Year ended December 31, | | |
|---|---|---|---|
| | 2011 | 2010 | 2009 |
| Selling and marketing | $ 8 | $ 39 | $ 377 |
| General and administrative | 161 | 178 | 252 |
| Total stock-based compensation expense | $ 169 | $ 217 | $ 629 |

The Company applies ASC 718 and ASC 505-50 for equity instruments that are issued to other than employees for acquiring, or in conjunction with, selling, goods or services.

r. Fair value of financial instruments:

The following methods and assumptions were used by the Company in estimating fair value disclosures for financial instruments:

The carrying amounts of cash and cash equivalents, trade receivables, other accounts receivable, short term loans and trade payables approximate their fair value due to the short-term maturities of such instruments. The carrying amounts of long-term loans approximate their fair value.

Assets and liabilities measured at fair value on a recurring basis as of December 31, 2011 are comprised of foreign currency forward contracts (See Note 4).

Assets measured at fair value on a non-recurring basis as of December 31, 2011 are Investment in shares of a cost method investee and intangible assets that were written down to their fair value as a result of an impairment loss.

ASC 820 establishes a three-tier value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

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

Level 2 -Include other inputs that are directly or indirectly observable in the marketplace.

Level 3 -Unobservable inputs which are supported by little or no market activity.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

s. Reclassification:

Certain 2010 figures have been reclassified to conform to the 2011 presentation. The reclassification had no effect on previously reported net income or shareholders' equity.

t. Impact of recently issued accounting pronouncements :

In May 2011, the FASB issued ASU 2011-04 to amend ASC 820, "Fair Value Measurement." The amendment requires companies to disclose the valuation techniques and inputs used to develop the measurements for assets and liabilities that are measured at fair value on a recurring or nonrecurring basis in the statement of financial position after initial recognition. For recurring fair value measurements using significant unobservable inputs (Level 3), companies are required to disclose the effect of the measurements on earnings (or changes in net assets) or other comprehensive income for the period. This guidance is effective for interim and annual periods beginning after December 15, 2011. The Company does not believe that the adoption of this guidance will have a material impact on its consolidated financial statements.

In June 2011, the FASB issued ASU 2011-05 (an amendment to ASC 220—"Presentation of Comprehensive Income"), which requires an entity to present total comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements and eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. This guidance is effective for fiscal years and interim periods, beginning after December 15, 2011. The Company's adoption of ASU 2011-05 will not have an impact on its financial statements.

In September 2011, the FASB issued ASU 2011-08, (an amendment to ASC 350, "Intangibles—Goodwill and Other"), which amends Topic 350 to allow an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. An entity would not be required to calculate the fair value of a reporting unit unless the entity determines, based the qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. This guidance is effective for annual and interim goodwill tests performed for years beginning after December 15, 2011. Early adoption is permitted. The Company's adoption of ASU 2011-08 is not expected to have an impact on its financial statements.

In December 2011, the FASB issued ASU. 2011-12 (another amendment to ASC 220), which indefinitely deferred certain provisions of ASU 2011-05, including the requirement to present reclassification adjustments out of accumulated other comprehensive income

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NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

By component in both the statement in which net income is presented and the statement in which other comprehensive income is presented. This amendment is effective for both annual and interim financial statements beginning after December 15, 2011. The Company’s adoption of ASU 2011-12 will not have an impact on its financial statements.

NOTE 3:- OTHER ACCOUNTS RECEIVABLE AND PREPAID EXPENSES

| | December 31, 2011 | December 31, 2010 |
|---|---|---|
| Government authorities | $ 92 | $ 213 |
| Advances to suppliers | 411 | 536 |
| Prepaid expenses | 172 | 57 |
| Deferred expenses attributed to software projects | 52 | 146 |
| Receivable in respect of investment sale | - | 127 |
| Derivative asset | - | 63 |
| Other | 17 | 41 |
| | $ 744 | $ 1,183 |

NOTE 4:- FAIR VALUE MEASUREMENTS

In accordance with ASC 820, derivative contracts are classified within Level 2 as the valuation inputs are based on quoted prices and market observable data of similar instruments.

The Company's financial liabilities and assets measured at fair value on a recurring basis, consisted of derivatives which were classified within Level 2 and amounted to a ($ 67) liability and a $ 63 asset as of December 31, 2011 and 2010, respectively.

As of December 31, 2011, the Company's investment in Surf (a cost method investee) was measured at fair value of $ 68, on a nonrecurring basis, due to other–than-temporary impairment of $ 39. The fair value was determined based on the price set at a new equity financing round raised by the investee in 2010 and was classified as Level 2 in the ASC 820 hierarchy (i.e., quoted price of identical asset in a non-active market).

NOTE 5:- INVENTORIES

| | December 31, 2011 | December 31, 2010 |
|---|---|---|
| Raw materials | $ 189 | $ 135 |
| Finished goods | 3,831 | 4,990 |

| | | |
|---|---|---|
| | $ 4,020 | $ 5,125 |