



State of Israel

STATE COMPTROLLER REPORT

JERUSALEM
NOVEMBER 2022



ABSTRACTS

State Comptroller Report

N o v e m b e r 2 0 2 2

A b s t r a c t s



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Foreword

The annual audit report submitted today to the Knesset is the first part of the State Comptroller's annual report presenting the audit findings regarding the audited entities for 2021.

The report mostly deals with audits concerning the economy and the national infrastructures, which are essential building blocks for the development of the economy and improvement of the quality of life of the country's citizens and residents. The report also includes an extensive chapter on the salary structure and employment in the public service. The audit chapters focus on important and diverse issues, and the audit is also done "through the eyes of the public", that is, the issues are also examined from the public's point of view and regarding their impact on the daily lives of the citizens and residents. Following is an overview of some of the audit chapters.

- **Consumer Protection Issues:** The consumer public in Israel, especially consumers from among populations deserving support, such as new immigrants, the elderly and minors, are in many cases at a disadvantage vis-à-vis business owners. Consequently, laws were enacted to ensure the rights of consumers and a government regulation system was established to implement the provisions of the laws on consumer issues and enforce them.

The audit on consumer protection issues raised deficiencies in a variety of topics related to service to the consumer and the quality of the response given by various government bodies in cases of violation of its rights. A public participation survey conducted by the State Comptroller's Office raised that more than 76% of the public experienced consumer wrongs in 2020–2021. The value of vouchers that consumers who are members in membership clubs do not redeem every year is estimated at approximately NIS 16.6 million; Of which approximately NIS 6.3 million is the value of expired vouchers, which the Pais (lottery) Club (NIS 2.9 million) and the "Tov", "Hever" and "Together for You" membership clubs did not return to consumers who did not use them. About 77% of consumers are not aware of the terms that allow them to cancel credit card payments. About 20% of the open complaints at the Israeli Consumer Council in 2018–2020 were closed to reduce the number of complaints registered as not handled; Only 31% of the sanctions imposed by the Consumer Protection Authority on businesses in 2018–2021 were collected (NIS 37 million out of NIS 119 million).

The parties entrusted with assisting and protecting consumers – including the Minister of Economy, the Consumer Protection and Fair Trade Authority, the Israel Consumer Council and the Ministry of Economy and Industry – should rectify the deficiencies noted in the audit and consider the implementation of the recommendations to prevent harm to consumers, improve the service and raise the level of satisfaction with the entities responsible for protection of their rights and the trust in them.



- **Digital Banking:** Digital banking provides a variety of tools and solutions designed to benefit consumers as they enable the consumption of banking services through digital channels – on mobile phones and on the Internet.

The audit on digital banking raised that the average discount rate on tariffs for the execution of an action in the banking system through a direct channel, compared to its execution by a clerk, is 69%. It was further found that the average annual profit of the five largest banking groups increased from NIS 10.4 billion in 2014 to NIS 22.1 billion in 2021. This indicates the centralization in the banking industry and the lack of sufficient competition, raises doubts as to whether the savings due to digital efficiency are fully passed on to the public and highlights the need for the Bank of Israel and the Banking Supervision Department therein to initiate actions to increase competition in the banking industry, so that digital efficiency manifests itself more significantly in the reduction of costs for the consumer. The Ministry of Finance and the Bank of Israel promoted the reform without addressing the barriers that make it difficult for the public to effectively use the mobility system, including the psychological barrier, poor financial education and the lack of substantial differences between the banks. It was found that about a third of Israelis aged 20 and up are unable to perform banking operations through direct channels without the help of a bank teller; Low success rates were recorded among the elderly (more than half of those aged 65 and up), in the Arab sector compared to the Jewish sector and among women compared to men. It was further raised that in 2020 there were 16.2 bank branches per 100,000 adults in Israel compared to an average of 18.3 in the OECD countries.

The frequent changes in the financial system, originated in significant technological developments, require adaptation of the regulation. The regulation should be inclusive, relevant and flexible to promote innovation, remove barriers and create certainty. Digital banking facilitates potential for increasing competition in a conservative and centralized market and for reducing the black economy. It is recommended that the Bank of Israel and the Ministry of Finance encourage the entry of local and international entities to optimize the industry, benefit consumers, and contribute to reduce the cost of living in Israel. It should also be ensured that the transition to digital banking is done with attention to populations deserving support, who do not have the literacy required to navigate the financial and digital world.

- **Aspects of Effectiveness of the Tax System:** The tax system is intended to serve as a tool for collecting taxes from the country's residents to finance public services such as security, physical infrastructure, health, education and welfare. Deficiencies in the tax system directly affect the general public. In 2020, the state's revenues from direct and indirect taxes were NIS 362 billion (gross). The audit examined various aspects of the effectiveness of the tax system in Israel.

The aforementioned examination raised various deficiencies in these aspects, affecting the operation of the Tax Authority and its efficiency vis-à-vis the taxpayer. Among other



things, it was raised that as of 2020, 825,000 (about 70%) of the reports that were required to be submitted to the Tax Authority, are from self-employed persons when the tax collected therefrom constitutes 6% of the total collection of direct and indirect taxes in the said year. The audit also presents findings on tax benefits that have been granted over the years without a periodic review of their compliance with the legislator's goals. It was also found that at the audit completion, approximately 20 years after the government's decision to consolidate the activities of the "Customs and VAT Division, the Income Tax Commission [Division] and the Computerized Processing Service (Shaam)", the consolidation of the regional offices and the vision of "One Point of Service" is still far from being realized, and is different from what is customary in tax authorities in leading countries in the world.

The Ministry of Finance and the Tax Authority should rectify the deficiencies raised in the audit while considering its recommendations, to improve the effectiveness of the tax system in Israel. The tax laws in Israel are complex and include many legal provisions, regulations and precedents, and this highlights the need to base the tax rules on short, unambiguous and easy-to-implement principles to minimize the need to publish supplementary administrative instructions. Digitization processes should also be promoted, including creating a computerized audit file and abbreviated assessments for relatively small businesses; Shorten appeal procedures on tax assessments and promote equitable enforcement among taxpayers.

- **Streamlining at the Israel Electric Company Ltd.:** The Israel Electric Company Ltd. (IEC) is a government and public company and approximately 99.85% of its shares are held by the Israeli government. The Company produces electricity and supplies it to all the economy sectors in Israel. Until the last decade, the industry was largely operated by IEC, which had a monopoly in all electricity sectors. In 2018, the government adopted a resolution on a reform in the electricity sector and a structural change in the Israel Electric Company, among other things to optimize the industry, encourage competition therein and strengthen IEC's financial stability.

The audit on optimizing the IEC was conducted in the middle of the reform's implementation period, but it is already evident that about 44% of the benefits that were expected to be obtained therefrom (NIS 2.72–2.78 billion, out of NIS 6.237 billion) will not be obtained due to the presentation of high benefit estimates when the resolution on the reform was adopted. The cost of the reform (in capitalized values) amounts to NIS 7.1 billion, of which NIS 6.4 billion are for financing the retirement costs of employees retiring within the framework of the reform and for an increase in the pension allowance for all Company employees.

It was further found that in 2021, 196 minutes of non-supply were recorded, an increase of about 28% compared to 2017. This is despite the fact that the reform is supposed to reduce the minutes of non-supply. IEC is implementing the various optimizing measures set in the reform, but it is evident that these measures as a whole do not realize the



necessary improvement in the Company's efficiency in particular and the efficiency of the electricity sector in general, and it is clear that further steps will be required for the optimization of the Company and the electricity sector.

It is recommended that the Minister of Energy and the Minister of Finance, together with the Committee for Monitoring Financial Soundness of the IEC and the Committee for Monitoring the Implementation of the Reform, survey the progress of the reform implementation and the Company optimization and consider additional ways to streamline the Company and the electricity sector. Furthermore, the Ministry of Energy, the Ministry of Finance, the Government Companies Authority, the Salary Commissioner, and the Electricity Authority should analyze the results of the reform and draw the lessons for the benefit of formulating future reforms in the electricity sector and in general.

- **The Progress of the Light Rail Project in the Tel Aviv Metropolitan Area:** The Tel Aviv metropolis spans an area of approximately 1,500 square kilometers. Annual travel using public transport is distributed as follows: approximately 767 million travels by bus (about 87%); Approximately 68 million travels by Israel Railways (about 8%); And approximately 45 million travels by the light rail (about 5%). In view of the scarce use of public transportation and the low scope of the transportation infrastructure in Israel, the country suffers from the greatest traffic congestion among the OECD countries, and according to the OECD data, in 2019 the loss of GDP as a result of congestion was approximately NIS 20 billion. In 2005–2016, the governments of Israel adopted several resolutions to promote the mass transportation system, intended to improve the accessibility of public transportation and its availability.

The audit on the progress of the Light Rail Project in the Tel Aviv Metropolitan Area raised the following deficiencies: the completion date for the construction of the Red Line was postponed six times by approximately five years, cumulatively (five of the six postponements occurred in the years 2010 to 2013 before the start of the main construction works, that began in 2015). The opening of the Purple Line was postponed from 2025 to 2026, and the opening of the Green Line was postponed from 2025 to 2027 and there may be a postponement of another year on these two lines. In the Red Line Project, at least 12 updates were made to the project cost estimate, and in at least eight of them the total project cost was updated; In the last update, the cost estimate was about NIS 18.71 billion, about NIS 8 billion higher than the original cost estimate (75%) and after deducting the effect of price increases and a change in VAT, is about NIS 7.5 billion higher (about 70%). Many changes were made to the Green and Purple Lines in the scope of hundreds of millions of NIS, both in the total estimate and in the main budget items of the project. Examining the cost estimates of the Green, Red, and Purple Lines against international comparative numbers shows that the cost of establishing an above-ground light rail project in Israel is higher than the cost of establishing it in other countries, and the cost of establishing more complex light rail projects, including a large underground component, is more comparable to the cost of establishing them in other countries.



Rectifying of the deficiencies raised in this chapter may improve the quality of life of public transportation users in the Tel Aviv metropolis, reduce the difficulties experienced by the residents of the metropolis on the route of the lines during the construction phase and save high costs for the economy. It is recommended that the Ministries of Transportation and Finance draw conclusions from the project segments that were carried out and apply them to the planned segments of the light rail and in future mass transit projects such as the metro. It is further recommended that when bringing transportation projects for government approval or for the approval of budgetary changes in projects of this type, the Ministries of Transportation and Finance present lessons learned from similar projects.

- **The Supply of Drinking Water in Times of Emergency:** Water is an essential and existential commodity for human and living things. Disruption of the water supply or damage to the quality of drinking water may affect both public health and orderly life routines. The potential threats to the water supply are diverse and may materialize without prior warning. According to the National Emergency Management Authority (NEMA) and the Water Authority's viewpoint, the most serious reference scenario the water sector should prepare for in terms of water supply during an emergency is an earthquake.

The audit on the supply of drinking water in times of emergency raised that more than 2.4 million Israeli residents live in local authorities that are not properly prepared for the supply of water during an emergency, and that 13,161 hospital beds are located in hospitals whose water reservoirs are not protected against earthquakes. It was further found that the Water Authority has no information on the amounts of water that residents store for emergencies; it did not undertake publicity activities to raise the residents' awareness of the need to store water as required, and the water suppliers are not fully prepared for alternative supply of water.

The Ministry of the Interior, the Water Authority and NEMA should cooperate to improve the preparedness of small local authorities and authorities ranked in low-level clusters according to the socio-economic index, for supply of water during an emergency. It is recommended that these bodies consider providing an alternative solution for water supply in the first hours after an emergency event occur. The Ministry of Energy, the Water Authority, the Ministry of Health and the hospitals should examine the recommendations included in the audit report and rectify the deficiencies.

- **Energy Infrastructures Ltd. – Financial Audit:** Fuel products are essential for the normal operation of the entire economy, and they currently play a central role in the development of the economy and its financial growth. Energy Infrastructures Ltd. is a government company fully owned by the state, established to meet the needs of the fuel industry, including storage, flow and supply of fuel products.



The financial audit of the Company raised that from the expiry time of the Company's concessions in January 2001, over 20 years ago, the Company and the state do not have a signed operating agreement. According to an estimate by the State Comptroller's Office, the lack of an operating agreement resulted in an economic loss (losses to the state and the Company) of NIS 216–659 million. It was further found that according to the Company's audited financial statements, at the end of 2020, over NIS 1 billion were accounting eligible for distribution as a dividend, however, the Company did not distribute dividends to the state on a regular basis. The rate of administrative and general expenses from the Company's revenues in 2018–2020 (13%) was higher than the rate determined by the Price Committee in the Energy area (about 9%).

The Ministry of Finance, under the leadership of the Accountant General, the Ministry of Energy, the Government Companies Authority, the Tax Authority and ILA should complete the formulation of an agreed operating agreement with the Company. The Government Companies Authority should cooperate with the Company's board of directors to distribute dividends to the state.

- **The Salary and Employment Structure in the Public Service:** Salary is a key factor in the set of people's considerations, when deciding to work in a certain organization, what position and whether to move between positions and between organizations. From an employer's point of view, the salary is a central tool for the recruitment and development of skilled and reliable personnel to carry out the organization's tasks. For more than three decades, various professionals, including those appointed by the government, have insisted on the need to address fundamental issues concerning the salary and employment structure in the public service in Israel – having about 540,000 positions (excluding positions in the defense agencies), whose annual employment cost in 2019 was approximately NIS 107 billion.

This audit report indicates deficiencies in the management of salaries and employment in the civil service, in several aspects: **the strategic aspect** – the government did not formulate or approve a government policy in the field of salaries; **The individual aspect of the salary components** – the salary in the civil service includes hundreds of salary supplements and salary components that are no longer applied adequately with their original purpose, and mechanisms to reward and motivate employees for which government spending in 2020 was NIS 707 million, of which NIS 667 million was for incentive pay, even though their effectiveness is questionable. **The equality among employees and bodies** – in the civil service, and at least in the national occupations therein, the principle of paying similar salaries for work of similar value is not preserved, which may harm the ability of ministries to improve the service they provide to the public due to the relatively low salaries paid to their employees. The report also presents a network of salary linkages and wide-ranging consequences, especially regarding salaries in the defense system, whose manner of application actually increased the disparity between the salaries of those serving in the IDF, the police and the Prison Service and the salaries of civil servants; **The financing of the salary increase** – the government



signed a framework agreement in April 2016 and allocated funds for its realization, not in accordance with the principle underlying the numerator, and as a result was forced to allocate hundreds of millions of additional NIS to finance the agreement.

The findings of the audit and the data underlying them emphasize the need for the government to establish a comprehensive policy in the field of employment and salaries in the civil service system and implement it.

- **Follow-up Audits:** The State Comptroller's Office places special emphasis on monitoring the rectifying of deficiencies noted in its audit, and in recent years we have significantly expanded the scope of follow-up audits. This report includes five follow-up reports on these topics: **Aspects of Cumulative Pensions and the Pension Distribution Market; The Service for Passengers of the Light Rail in Jerusalem; Israel Postal Company Ltd. – International Mail Handling; The Government's Handling of the Increase in Online Commerce; The Public Service at the Tax Authority** (an extended follow-up audit was conducted on this topic).

The preparation of this report, like those preceding it, required considerable effort from the State Comptroller's Office staff members, and especially in the Economy and National Infrastructures Auditing Division and at the Headquarters, who fulfil their public duties out of a true sense of dedication. They worked on its preparation with professionalism and thoroughness, and they have my gratitude.

I do not disregard that in many of the audited bodies, positive actions have been taken and the more notable of them were expressed in the report as required by the State Comptroller Law. At the same time, it is the duty of these bodies to rectify the deficiencies noted in this report to optimize their activities and improve the public service in Israel.

Matanyahu Englman
State Comptroller and
Ombudsman of Israel

Jerusalem, November 2022



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Chapter one

Systemic Issues



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November 2022

Systemic Issues

Loans and Credit Sources of Various Entities



Loans and Credit Sources of Various Entities

Background

Credit sources, such as loans and debt through bond issuance (Bonds), are crucial for any economic entity. On the one hand, proper and controlled leverage can bridge cash flow problems, maximize the entity's profits and enable its development and thriving. On the other hand, leverage at an unreasonable level holds many risks, such as economic instability and even, bankruptcy.

The Compulsory State Loan Law 1979 enables the government to borrow money for the state's needs and thereby maximize the benefits arising from the issuance of Bonds. Accordingly, the Accountant General's Division in the Ministry of Finance handles the process in a centralized manner. On the other hand, various entities – government companies, local authorities, municipal corporations, health funds, and statutory corporations – can issue Bonds and take loans within certain limits. Several financing options are available to the above mentioned entities: banks, the private loans market (institutional investors – pension funds, insurance companies, study funds, and provident funds), bonds issued to the institutional investors in a private offering, and bonds issued on the stock exchange in a public offering.

This report reviews the financing methods of government companies, local authorities, municipal corporations, health funds, and statutory corporations and presents the extent of change in the financing methods over the years and their adaption to the credit market changes.



Key Figures

**NIS 80
billion**

total corporate bond issued in the entire economy in 2021

**NIS 15
billion**

the burden of loans¹ of the local authorities as of December 31, 2019

2.01%

the ratio of local authorities' debt to GDP in Israel (low compared to most OECD member states)²

82%

of the local authorities loans approved by the Ministry of Interior, at about NIS 12.8 billion, are taken from four out of 15 banks

63%

the traded debt ratio of the total government companies bonds, compared to the traded debt ratio of corporate bonds, which is 92% as of 2021

only 4

local authorities issued municipal bonds before 2006. Compared to the municipal bond market in the United States at USD 4 trillion for 2021


100%

the financing sources of the health funds in 2020 are based on short-term credit facilities (NIS 709 million)

**NIS
2,076
million**

the financing expenses of government companies in 2020

Audit Actions

 From July 2021 to March 2022, the State Comptroller's Office examined aspects of the various modes of financing of multiple entities: government companies, local authorities, municipal corporations, health funds, and statutory corporations. The examination included a review of the potential and competitive financing routes available to the entities above: bank credit, institutional credit, and non-bank credit, bonds issued to institutional investors in a private offering, and bonds listed on the stock exchange in a public offering. The examination was conducted in the following bodies: the Ministry of Interior – at the Municipal Corporations Division and the Budgets Division; The Ministry of Finance – at the Accountant General's Division and the Budgets Division; The Ministry of Health – at the Control over Health Funds and Additional Health Services Division




1 The balance of the loans that each local authority must repay in the following years.

2 Figures correct for 2018.



(Shaban); The Government Companies Authority, including the Listings Unit and the Airports Authority. Completion examinations were conducted at the Securities Authority and the Center for Local Government.

Key Findings

-  **The Debt Ratios of the Local Authorities** – the balance of the loans the local authorities must repay in the following years (the burden of loans) as of December 31, 2019, was about NIS 15 billion; most of the loans are bank credit. For the local authorities, credit is a source of financing for financial and operational efficiency and development projects contributing to the economic growth of the authority. The ratio between the local authorities' debt to the GDP in Israel (2.01%)³ is low compared to most OECD member states. The ratio between the local authorities' debt to the public debt in Israel (2.83%) is also low compared to most OECD member states.
-  **The Approval and Control Procedure for Granting Credit Permits to Local Authorities by the Ministry of Interior** – in 2019–2021, the Ministry of Interior granted local authorities permits for loans at about NIS 15 billion. The audit raised that (a) the Ministry of Interior's work procedure for credit approval was not distributed to the local authorities and is not published on the Ministry of Interior website; (b) the procedure has not been updated since 2010, despite the transformations and changes in the credit market; (c) the Ministry of Interior headquarters has not formulated a procedure for all the districts regarding the method of checking the application for credit permits – from the application submission by the local authority until its approval by the authorized body – and each district in the Ministry of Interior checks the permit according to its professional discretion; (d) the Ministry of Interior's examination of the loan is almost identical to the examination by the districts themselves and creates unnecessary bureaucracy.
-  **The Time Required for the Ministry of Interior Approval of the Local Authorities' Requests for Loan** – it was raised that the average time for the approval of such a request – from the submission date by the Northern District to the Ministry of Interior Administrative Headquarters until the approval date by the Ministry of Interior Administrative Headquarters – is 49 days. It should be noted that this period does not include the review duration of the loan application by the district itself. Furthermore, five cases (13%) were found where a request was approved after 100 days. Approval of a loan application after a prolong period of time delays the loan acceptance procedure. Moreover, in such periods, the loan terms offered by the banks can change

3 The figures are correct for 2018.



substantially, and the banks can even begin the loan approval process again, thus delaying the process.

 **Determining Parameters or Limitations by the Ministry of Interior Regarding Loan Routes Taken by Local Authorities**

– differences were found between the terms of loans approved for the local authorities; thus, the maximum interest rate on loans not based on a prime-based variable interest rate is 7%, and the maximum interest rate for a prime-based variable rate loan is 3.38%. However, the Ministry of Interior did not set parameters or limits regarding the loan routes taken by the local authorities. The loan route (indexed, variable interest rate, etc.) may affect the financial resilience of the local authority and the risk it is exposed to. For example, development loans are often considerable volumes of loans for long periods. During the loan period, many changes in the market are expected, such as changes in the Bank of Israel interest rate, inflation rates, or government bond yields, and they may directly affect the pricing of the loans.

 **Diversification of Banks' Credit Taken by Local Authorities and Loan Recycling**

– 82% of the local authorities loans are from four out of 15 banks: Bank A, Bank B, Bank C, and Bank D⁴. It was found that there are no Ministry of Interior instructions to local authorities to compare the various banks loans before taking the credit, and a local authority may contact one bank only and take a loan from it without getting price offers from other banks. Moreover, out of about NIS 15 billion in loans taken by the local authorities, 48 authorities recycled debts of about NIS 2.1 billion (approximately 15% of the total volume of loans taken) in 2019–2021. The Ministry of Interior did not recently organization-wide instruct local authorities regarding options to save in financing expenses by recycling a loan due to a low-interest rate environment.

 **Issuance of Bonds by Local Authorities**

– since 2006, no municipal bonds have been issued by local authorities. Only four out of 257 local authorities issued municipal bonds, only in 2005–2006. The total par value issued was about NIS 470 million, compared to the municipal bond market in the USA of about USD 4 trillion in 2021. Moreover, to issue bonds, the local authority must publish a prospectus, including financial statements prepared according to generally accepted accounting principles. However, the local authorities' financial statements are not prepared according to generally accepted accounting principles, and therefore they cannot be submitted to publish a prospectus for the issuance of bonds.





 **Credit Permits for Municipal Corporations**

– 59% of the total loan permits granted to municipal corporations in 2020 are for Tel Aviv-Yafo Municipality. It was also found that four resilient municipal corporations were required to apply to the Ministry of Interior for credit permits to issue guarantees in immaterial amounts (between NIS 9,000 to NIS


4 It should be noted that Bank D provides loans to the local authorities that are in the recovery plans, and against these, it is given assignment of rights at the rate of 25%–45% of the balancing grant of the local authorities receiving the loan.



47,000) compared to the scope of their financial activity, which is tens to hundreds of millions of NIS, and this is for participation in official calls for bids and government tenders.

-  **The Financing Methods of the HMOs** – the HMOs do not use additional financing alternatives other than the arrangement of short-term credit facilities for a total of NIS 709 million as of December 31, 2020. Maccabi Health Services is the only HMO that presents long-term loans in its financial statements, as companies held by it take long-term loans, and on December 31, 2020, the balance of these loans was about NIS 461 million. These differences in the loans in the long run can create a difference between the health services provided to the public since a fund that takes long-term loans will be able to carry leveraging and expand health services to its insured. In contrast, a fund that does not take long-term loans will have more difficulty constructing long-term projects.
-  **The Financing Methods of the Airports Authority** – although the Airports Authority's Finance Committee recommended in September 2020 to issue institutional bonds for the long term, until May 24, 2021, the Authority had utilized NIS 465 million from the short-term credit facilities. It should be noted that after the audit completion date, at the end of June 2022, the Authority issued bonds to institutional investors.
-  **Costs of Issuing Bonds in Government Companies Compared to Issuing State Bonds** – on December 31, 2021, the scope of government companies' bonds was about NIS 32 billion. By analyzing issuances by government companies (Israel Ports Company, Israel Electric Corporation, Mekorot, Rafael, Israel Natural Gas Lines, Energy Infrastructures Ltd., and Israel Railways) in 2019–2021, their average margin compared to the government bond yield is 0.73%. Hence, the financing cost of government companies' debt and not of the state is estimated at millions of NIS.
-  **Procedure for Distributing a Shelf Prospectus of Government Companies** – one of the means to increase the accessibility of corporations to the capital market and to ease restrictions is the publication of a shelf prospectus that allows the corporation to offer securities to the public at any time during 24 months from its publication date. According to the Securities Regulations (Period for Placing Orders for Securities Offered in a Prospectus), 2005, when expanding a series of securities, a company can make an issuance in seven hours, of which five hours are trading hours, i.e., this procedure is meant to be short. However, the Government Companies Authority does not have a procedure regarding the entities to whom the shelf prospectus and all relevant documents must be distributed. Furthermore, the Government Companies Authority does not set a time limit for receiving responses from the relevant government ministries, and the approval process can be prolonged. Therefore, the additional time for issuance based on the shelf prospectus for government companies is in practice about ten days to two weeks, and even more so in cases where comments are received from the relevant ministries.







 **The Rate of Tradable Bonds of Government Companies** – at the end of 2021, the rate of bonds issued by government companies to the public is 52%, while 36.59% are issued on Tact-institutional. This is compared to the traded debt rate of corporate bonds, which was 92% in 2021. However, it should be noted that in the last seven years, the traded debt rate of government companies increased by 3.25 times, from a rate of 16% to a rate of 52%.



The Activity of the Listings Unit at the Government Companies Authority – the State Comptroller's Office commends the Listings Unit activity to encourage government companies to diversify their credit sources. The inherent advantage of this unit is the counsel it gives to government companies in the pursuit of maximum returns and at few restrictions as possible.

Key Recommendations

-  It is recommended that the Ministry of Interior consider checking the loans both by the district itself and by its headquarters; hence the loan approval procedure will be efficient and will not result in an excess bureaucratic burden on the authorities. It is also recommended that the Ministry of Interior headquarters examine from time to time the loans approval policy and the parameters for their approval, publish a relevant procedure for all districts and authorities, and monitor the policy implementation by the districts.
-  It is recommended that the Ministry of Interior consider formulating a loan mix policy for the local authorities and their exposure to changes in the interest rate and the index (similar to the restrictions established by the Bank of Israel in the mortgage sector).
-  It is recommended that the Ministry of Interior consider instructing all local authorities to obtain a price quote from several credit providers to get the best credit terms. It is also recommended that the Ministry of Interior ease the requirements for municipal corporations that request permits for loans or credit, especially for low amounts, and establish criteria, such as the amount of the loan and the type of Municipal Corporation (as is done with the local authorities, which are divided into resilient and non-resilient authorities).
-  It is recommended that the Government Companies Authority and the Ministry of Finance examine models to reduce the excess costs of government companies raising capital through the state. It is further recommended that the Government Companies Authority continue to encourage government companies to issue bonds to the public in the appropriate cases and formulate a work procedure to streamline approvals obtaining from

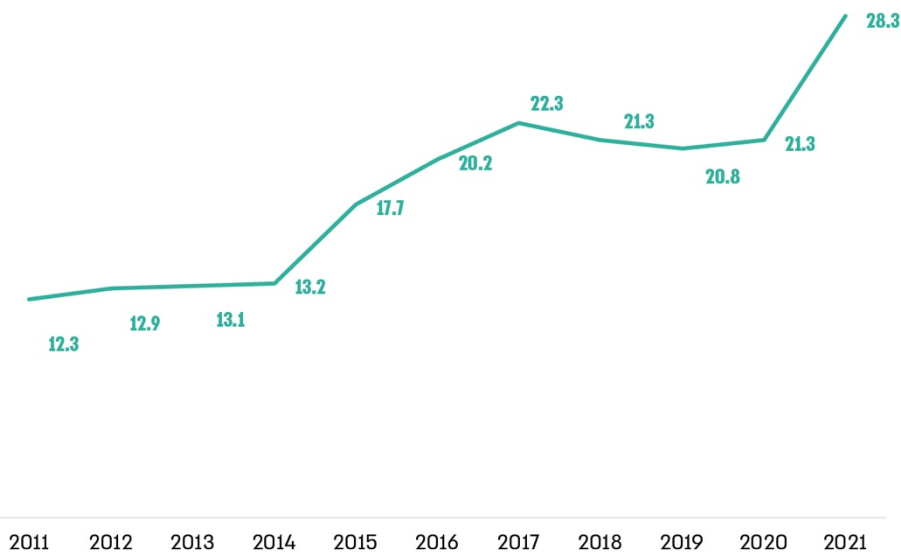


the relevant government ministries when issuing government companies bonds concerning misleading details.



It is recommended that the Ministry of Interior – in cooperation with the Accountant General, the Budget Division, and the relevant local government agencies – consider an outline for local authorities bond issuances, diversifying their financing sources. It is also recommended that the Ministry of Interior consider the transition of local authorities to report on a government accounting standard basis and present the data in the financial statements on an aggregated basis. This, among other things, will enable the authorities to meet the conditions required for listing securities on the stock exchange. Alternatively, it is recommended that the Securities Authority consider, in cooperation with the Ministry of Interior, issuance of municipal bonds regulation, considering the currently accepted accounting in the local authorities.

The Development of Local Authorities' Debt and Other Public Corporations Whose Debts are Included in the Public Debt, 2010–2021 (in NIS billions)



According to data from the Ministry of Finance, processed by the State Comptroller's Office .



Summary

The expansion of the financing sources of the various government entities and their diversification is significant to strengthen economic growth, encouraging and refining the tradable and non-tradable capital market, and creating alternatives to bank financing. Refinement and development of the capital market in Israel are expected to promote liquidity in the Israeli capital market, increase trading turnover on the stock exchange and improve the level of attractiveness of the local capital market for investors. All government entities usage of financing sources, such as funding from institutional bodies and the public investing in the capital market, can create an alternative to bank financing and thus increase competition in the debt markets and improve the process of interest rate determination in the banking channels as well.

The audit raised various barriers and bureaucracy imposed on the government entities, which brought most of the government entities (apart from the government companies) to choose the classic financing alternative – bank loans. In addition, some of the authorities responsible for the government entities do not encourage finding other financing solutions besides taking loans from the banks.

It is recommended that the Ministry of Finance, the Government Companies Authority, the Ministry of Interior, and the relevant authorities of the various government entities jointly find additional financing alternatives for the government entities and locate the barriers preventing these entities from turning to other financing channels (the size of the government entity, excessively high threshold requirements, incompatibility of the existing regulatory costs to the size of the government entity, etc.).



Report of the State Comptroller of Israel |
November 2022

Systemic Issues

The Salary and Employment Structure in the Public Service



The Salary and Employment Structure in the Public Service

Background

Salary is a key factor in people's decisions to work in a specific position and organization, and changing positions or organizations. From an employer's perspective, the salary is a central tool to recruit and develop skilled and reliable personnel to fulfill the organization's tasks.

In the public service (including government ministries, their auxiliary units, and government health institutions; local authorities; municipal companies; conurbations; government companies; religious councils; statutory corporations; and supported bodies), the overall salary framework was formulated in the 1950s, and since then many of its principles and characteristics were unchanged. The public service detailed salary conditions are set in agreements due to negotiations between the workers' organizations, the employers, and the state.

The Salary and Labor Agreements Division at the Ministry of Finance serves as the Israeli government headquarters, formulating the salary policy in the public service and its implementation within the government's economic policy. Moreover, it formulates salary agreements, working conditions in government bodies, and their supervision in public bodies.



Key Figures

**NIS
107 billion**

public service employee's cost in 2019 (not including employment in the defense agencies)

over 700

number of salary components in the salary slips in the ministries

**NIS
700 million**

the annual expenditure for the car expenses reimbursement for ministry workers in 2019

**NIS 179
million**

the government expenditure on the on-call supplement in the ministries in 2020

**NIS 707
million**

the government expenditure on reward and motivation mechanisms of employees in the ministries in 2020, of which NIS 667 million is for incentive pay

only 31%

the rate of units' managers operating a differential reward method to motivate employees, stated that the method has improved employee productivity to a great or very great extent

only 16%

the rate of agreements, 24 out of 150 relevant salary agreements in 2016–2021 that include the promotion of goals set by the Salary Department in the salary structure and employment

only 2%


the rate of public service employees for whom the Salary Department set strategic goals in the salary structure and employment within the salary agreements in 2016–2021

**NIS 457
million**

the government expenditure to cover budget overrun due to the signing of a framework agreement without a balancing action



Audit Actions

 From May 2021 to January 2022, the State Comptroller's Office audited the public service salary and employment structure, including the determination of the salary policy in the public service and its implementation; budgeting of salary agreements; salary linkages between sectors; the complexity of salaries in government bodies; encouraging productivity by dedicated rewards; salary components that no longer fulfill their purpose; and determining the salary in the IDF. The audit was carried out in the Ministry of Finance – in the Salary and Labor Agreements Division, the Accountant General's Division, and the Budgets Division. Completion examinations were carried out in the Civil Service Commission (CSC) and the IDF.

In January 2022, as part of examining productivity encouragement by salary supplements, the State Comptroller's Office distributed questionnaires to 16 CEOs and government bodies managers employing one of the methods to encourage productivity (differential compensation method, see below). The State Comptroller's Office also distributed satisfaction questionnaires to particular units' managers where the method is employed by the CEOs and the managers of the bodies, examining their position on the method's effectiveness. 16 CEOs and body managers and 81 unit managers responded to the questionnaires.

Key Findings



The Salary Policy in the Public Service

- **Government Policy** – over three decades, various professionals, including those appointed by the government, noted the need to address fundamental issues concerning the salary and employment structure in the public service in Israel, including: simplifying employment and the salary structure (which also has about 700 salary components in the ministries), encouraging productivity, reducing salary disparities resulting from seniority, adapting salary conditions to a competitive working world, increasing administrative flexibility and strengthening conflict resolution mechanisms. However, the government did not formulate or approve a salary policy. The Ministry of Finance, through its Minister's authority over the salaries of public service employees, did not propose a government or an overall ministry policy. The present core issues policy is the policy of the Salary Division in the Ministry of Finance, which the other government representatives are not obliged to consider.



- **Dealing with the Fundamental Issues Through Salary Agreements** – the Salary Division partially promoted the fundamental issues and its goals in salary and employment structure within the salary agreements framework – promoting four issues (simplifying the salary and employment structure, encouraging productivity, adapting salary conditions to a competitive work world and managerial flexibility) was achieved to a limited extent, and the changes apply to 0.6% to 10% of public service employees. Strategic changes were promoted on a limited scale in all the fundamental issues. These apply cumulatively to about 2% of the public service employees (for example, on the issue of encouraging productivity – to about 0.2% of the employees and reducing seniority gaps – to about 1% of the employees).

Budgeting of Salary Agreements

- **Formulating the Numerator Considering Expected Salary Agreements** – it was raised that in July 2021, the Ministry of Finance publicized the multi-year budget plan (the numerator) for 2022 to 2025, assuming that "in 2021–2022, no new salary agreements will be signed with budgetary implications in the entire public sector". Furthermore, a dispute arose between the Salary Division and the Budget Division regarding basing the multi-year budget plan on this assumption. The Salary Division said the assumption was not based on a factual foundation and was not coordinated with the Salary Division. By the Budget Division, the assumption was well-founded. It was found that in 2021–2022 a salary agreement between the government and a representative organization of the social workers, and a package deal including several agreements with workers' organizations were signed, and at the audit end, a labor dispute with the Teachers Union concerning over 100,000 employees (Histadrut) was pending. Regarding the salary agreement between the government and a representative organization of social workers, the Budget Division stated that the budget to finance this agreement was already reserved in 2019; Regarding the package deal, the Salary Division noted that a "cost framework for solving problems" of about NIS 500 million was allocated. Formulating the numerator on the assumption that no new salary agreements with budgetary implications will be signed in the relevant period should also be based on professional consultation with the Salary Division regarding expected salary agreements during the multi-year plan period. Otherwise, the government might exhaust its sources and will not leave adequate sources to finance expected salary agreements.
- **Financing the Postponement of Part of the Salary Supplements in the Framework Agreements from April 2016** – upon signing the framework agreement in April 2016, the government took upon itself a future commitment, but when formulating the 2017–2018 budget (during the second half of 2016), it turned out that the total government commitments for these years are higher than the total expenditure allowed according to the Deficit Reduction and Limitation of Budgetary Expense Law, 1992. Following the agreement signing, the government



did not take a balancing act, as the Budget Foundations Law required. The Ministry of Finance increased in August 2016 the future commitment due to the implementation of the agreement by about NIS 286 million a year starting in March 2019 – a postponement of payment of 1% salary supplement in exchange for 0.25% salary supplement, which is equivalent to a loan from the public at an annual interest rate of about 14%. In January 2018, the Ministry again increased the commitment by NIS 171 million from December 2019, for a total of NIS 457 million per year. The Ministry of Finance's actions to maintain the framework of the state budget for 2017–2018 and for 2019 were necessary as the signing of the original framework agreement in April 2016 was not done according to the principle underlying the numerator, by which an increase in government expenditure causing an overrun from the permitted government expenditure requires taking a balancing action.

- **Implementation of Salary Agreements** – the government signed the framework agreement in 2016; however, NIS 18.4 billion, 65% of the government spending on salary supplements in 2016–2020, was after the end of the agreement period and the "industrial peace" (of which NIS 14.7 billion in 2019–2020, after the numerator period). As a result, most of the payment of salary supplements and the commitment fulfillment were realized due to concerns of organized harm to work procedures and processes. For three years (2018–2020), the annual government expenditure on salary supplements set in the agreement was the highest. Still, the workers' representatives promised not to strike, in full or partially, against any of the employers or their units or to employ any other organized harm to the work procedures and its processes. Similar finding was raised regarding the agreement between the Federation of Local Authorities and the Teachers in the Secondary Schools and Colleges Organization. Regarding the salary agreement of the senior faculty in institutions of higher education – 50% of the salary supplements were during the agreement period and the "industrial peace."

Salary Linkages

- **Linking Salaries in the Defense System to Civil Service Salaries** – the cost of each 1% salary supplement established in a collective framework agreement with the New General Organization of Workers (Histadrut) was about NIS 600 million in 2021. The cost of linking the defense system salaries to civil servants' salaries changes is about an additional NIS 270 million (about 45%).
- **The Financial Expression of the Salary Supplements due to Linkage** – the government has established mechanisms updating the salary of permanent employees, police officers, and prison guards according to changes in the civil servant's salary since they are not allowed to join a representative labor organization and conduct collective negotiations regarding their terms of service. It was found that when the civil servants were given a NIS supplement to reduce



salary disparities, the government calculation consequently increased the discrepancy between the salary of the IDF, the police, and the IPS servants and between the civil servant's salaries.

The Complexity of Salaries in Government Bodies

- **The Complexity of the Salary and its Transparency** – a representative salary slip of a civil servant employed according to an appointment letter is complex and contains considerable data affecting the transparency of the salary and the ability to manage it at the systemic level. The basic component of the combined salary is 28%–73% of the total salary. The complexity of the salary had significant negative consequences for the employment in the public system in several aspects: low occupational mobility of employees and difficulty in recruiting suitable new employees; salary differences between employees without objective justification; the frail relationship between salary and employee productivity; and lack of transparency of the salary.
- **The Expenditure on the Total Salary and Salary Supplements** – there is considerable variation between the government ministries regarding the components of the average total salary for the position. For example, the combined salary tier ranges from 28% (in the salary of the Tax Authority employees) to 73% (in the salary of the Israel Land Authority employees) of the total salary, and the average expenditure on supplement in 2001 ranges from NIS 96 (in the Ministry of Religion) to NIS 12,629 (at the Ministry of the Interior).
- **Publication of the Salary Range in Public Tenders** – nine years since the government adopted a recommendation to publish salary ranges in public tenders, and seven years since the Civil Service Commission (CSC) was obliged to do it, the recommendation has not been implemented. As a rule, the CSC and the ministries do not publish the intended salary range in public tenders due to the salary structure and its complexity and dependence on the specific data of each candidate. At the tender stage, the CSC does not have sufficient information for calculating and publicizing the salary range.
- **Multiple Occupations in the Civil Service** – in December 2021, the CSC compiled a model for the classification of about 11,000 occupations in the civil service into 17 professional knowledge clusters. As of the audit completion, the CSC had not completed analyzing the occupations of any of the 17 clusters and had not formulated a detailed work plan to complete this project.



Encouraging Productivity Through Dedicated Rewards

- **The Effectiveness of the Incentive Pay Mechanism** – incentive pay is the reward and incentive mechanism. It is the highest expenditure in the public service in Israel: in 2020, incentive pay payments to the ministry workers were about NIS 667 million¹. Despite its high cost, it was found that the salary mechanism is not effective. This is given the high premium exhaustion rates among employees (about 90% of the premium cap on a weighted average in 2020), and that salary methods are not updated as required in most ministries. Under these circumstances, salaries have a supplement nature and do not fulfill their purpose. In addition, there are considerable disparities in the salary payments between employees in the various ministries (for example, NIS 620 per month at the Ministry of Environmental Protection versus NIS 2,040 per month at the Taxes, Customs and VAT Authority), including between employees in the same professional ranking. These disparities are partly due to inequality in the definition of the salary methods indices and their employment.
- **The Extent of the Adequacy Between the Salary Indices and the Service Quality Provided to the Public** – there is no correlation between the rating of the ministries' work within the salary indices and the rating of the level of service they provide to the public, according to the service quality report of the Government Service Improvement Bureau at the Government ICT Authority. In 2020, by a central index in salary methods, the level of efficiency of the ministries was consistently higher than 100% and, in most cases, surpasses the upper limit set for this index (142%), and the rating of the level of service to the public in the measured ministries ranges from 53 to 82 out of 100.
- **The Effectiveness of the Differential Reward Mechanisms** – the Civil Service Commission (CSC) and the Salary Division operate mechanisms to incentivize employees through financial rewards based on their performance measurement. The Salary Division does not examine the effectiveness of its reward methods mechanism. The audit findings raise doubts about the methods' effectiveness and their contribution to motivating the employees and improving their performance and the quality of their work, and of the tool is used by the ministries according to the established principles: many of the units managers in the ministries employ differential compensation methods, doubt the effectiveness of the method and attribute minimal effect to the methods, including in increasing motivation (17%), improving productivity (27%) and promoting the organization's goals (28%). Many other managers attribute moderate effectiveness to the methods (38%, 42%, and

1 These sums do not include the cost of operating the reward and incentive units in the ministries, the salary payments in the public bodies and the expenditure on consulting services for the purpose of formulating and updating salary methods.



30%, respectively); Moreover, it was indicated that rewards were set, apparently not according to the quality of their performance.

- **Doubling of Differential Reward** – the CSC and the Salary Division employ the differential reward mechanisms separately and without sharing information. However, the main goals of the mechanisms are similar, and the criteria for calculating the reward are partly similar. 195 employees were entitled to double rewards in 2020, and the expenditure on double rewards was about NIS 2 million. 63% of these employees were rated differently by the CSC and the Salary Division: according to the CSC, they were classified as excellent. In contrast, the Salary Division classified them as medium to low. This inconsistency could adversely affect the employees' trust in the indices underlying the differential reward mechanisms, thereby harming the effectiveness of their employment.

Salary Components no Longer Suited for Their Purpose

- **On-Call Supplements** – the CSC did not define "on-call" from an operational standpoint, in the Civil Service Regulations (Takshir) when to activate it and the alternative tools for on-call. Moreover, it did not form criteria determining the need for on-call. The average annual government expenditure for on-call supplements in various ministries ranges from NIS 62 to NIS 510 and even up to NIS 14,000. This disparity raises the concern that salary increases are given for on-call, regardless of the need for employees to be on-call during non-regular working hours. The use of this tool in the different bodies and at the different levels of rewards is sometimes not suited to the needs of the various ministries. It is affected by the ability of the bodies to raise budgets.
- **Continued Education Remuneration** – Continued education remuneration is a fixed financial reward paid to civil servants as part of their salary for hours of study they accumulated in continued education courses. It originates from collective labor agreements signed starting in 1979. By a Civil Service Commissioner team report at the end of 2019, the continued education remuneration model encourages employees to quickly complete studies that grant remuneration, regardless of the employer's needs; Moreover, the remuneration creates an expectation that any training will be reflected in the salary, thus reducing motivation for continuous learning, which may affect the quality of work of veteran employees. The team recommended canceling the continued education remuneration and creating an alternative remuneration. It was found that the Salary Division began implementing its continued education remuneration policy in five public bodies. However, about 78% of civil servants were entitled to continued education remuneration at the time of the State Comptroller's report from 2018. The CSC, the Salary Division, and the Accountant General Division did not compile data on the scope of government spending on continued education remuneration.



- **Reimbursement of Vehicle Allowance Expenses** – by the Ministry of Finance data, about 80% of the ministries' employees and 40% of local authorities employees were entitled to reimbursement of vehicle allowance expenses in 2019, and the annual expenditure for the reimbursement of vehicle allowance expenses for the ministries' employees was about NIS 700 million in 2019. It was raised that the Salary Division canceled the reimbursement of vehicle allowance expenses in only one agreement. As for the rest of the civil service employees, there was no change.
- **Increased Benefits and Grants Under the "80 Agreement"** – by the Ministry of Finance, 25 employees who were entitled to increased benefits and grants following the "80 Agreement" (a collective agreement designed to compensate employees whose jobs were terminated following the peace agreement with Egypt) retired after 2005 – i.e., over 25 years after the agreement. Nevertheless, according to the agreement, these employees were entitled to benefits of about NIS 15.4 million. By a judgment verdict in January 2022, an employee whose job was terminated about a month before his retirement date at 67 won benefits over NIS 1 million under "Agreement 80". This raised a concern that benefits are paid to employees under this agreement many years after its execution, even though they no longer fulfill the original purpose.
- 👉 **Different Salary for Similar Work Value** – the transition of employees between similar positions within the civil service (in national occupations where the officeholders carry out work of equal value) from ministry to ministry may lead to a significant change in their salary – increase or decrease. Thus, the principle of paying similar salaries for work of similar value is not preserved. These differences constitute barriers to employee mobility within the civil service. Furthermore, the disparities may make it difficult for ministries where salaries are relatively low to recruit suitable employees, as they will prefer to work in ministries where salaries are higher. Hence, the salary disparities between the ministries may affect the productivity of those disadvantaged due to the low salaries and the quality of the service they provide to the public.
- 👉 **Determining the IDF Salary and its Control**
 - **The IDF Salary Policy Determination** – by the inter-ministerial team of the Ministries of Defense and Finance, the determination of salary policy in the IDF is under the authority of the Chief of Staff. This is not consistent with the opinion of the Deputy Attorney General.
 - **Disputes Between the Ministry of Finance and the IDF** – even though the Accountant General Division failed to audit the calculations accuracy of most of the IDF salary components (73% of them) in 2016–2017, and even though in the following years it received databases that allowed the completion of the audit, the Division did not conduct another audit, nor complete its audit from those years.



- By the Budget Division data, as of March 2022, there are disputes between the Ministry of Finance and the IDF regarding some of the salary components of the permanent employees, mainly salary components whose annual cost was about NIS half a billion, including tax gross-up for the reimbursement of vehicle allowance, reimbursement of personal expenses, vacation for families, paid retirement leave and various tax benefits.



The Salary Policy in the Civil Service – the State Comptroller's Office commends the Salary Division policy formulation of the salary and employment structure and its efforts to promote it, including establishing a unit that deals with it and serving as a knowledge center on the subject.

Key Recommendations



It is recommended that the Ministry of Finance propose a comprehensive government policy regarding salary and employment, considering the Salary Division policy, approved by the government and binding government entities, and its units, also for salary agreements negotiations.










It is recommended that the Ministry of Finance, based on an overall government salary policy, incorporate the policy principles in its actions to reach salary agreements, adapt the civil service in Israel to the changing reality, including technological, socio-economic, and demographic changes, and implement linkage mechanisms to their purposes. Including linkages of NIS salary supplements according to their purpose – reducing salary disparities without increasing salary disparities between groups of employees linked to each other. It is also recommended to implement concrete goals to simplify civil service salaries, increase occupational mobility, strengthen the link between salary and productivity, and increase salary transparency. This is while considering employee rights and labor laws.






It is recommended that the Ministry of Finance formulate multi-year plan (the numerator), in consultation with the Salary Division, present the government expected salary agreements included in the multi-year plan and their sources. Moreover, it should present to the various professional bodies in the Ministry of Finance with the salary agreement assumptions used for the multi-year plan formulation. Incorporating the financial cost estimate when formulating the numerator will also enable the implementation of the OECD report recommendation to determine a budget cap even before negotiations with labor organizations, improve the negotiation process and preserve the government's right to allocate public expenditures based on its priorities.



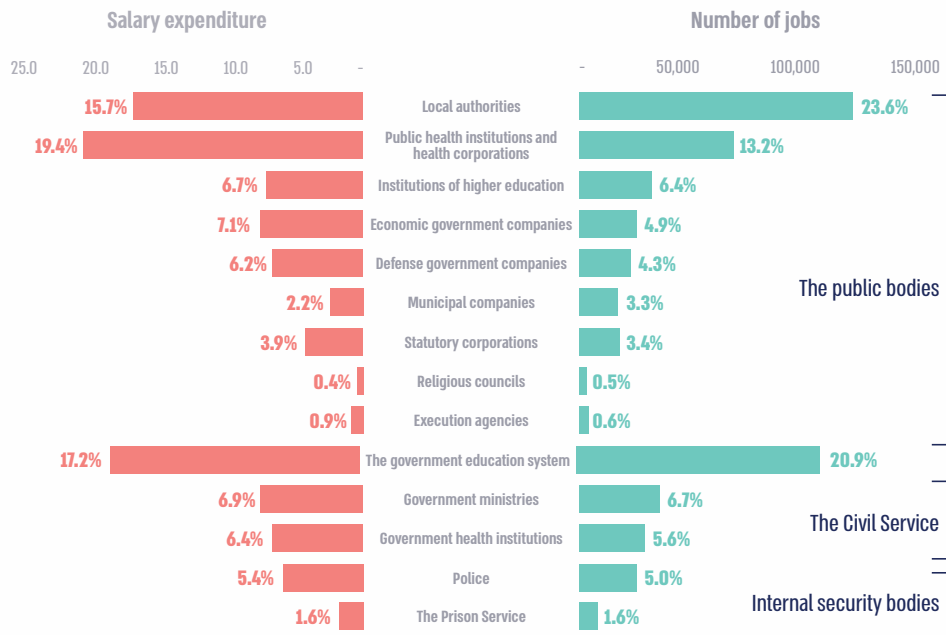
-  It is recommended that, as part of the formulation of a government salary policy, the Ministry of Finance discuss the government's future obligations to implement salary agreements, after the agreement periods, on its various aspects, including an increase in salary supplements when there is no commitment to industrial peace, and including acting ahead of time to formulate salary agreements. This is to formulate a government policy on this matter and implement it in salary agreements in the future. It is also recommended that the Ministry of Finance formulate salary agreements whose costs will be spread over the periods of the agreements, to the extent possible, with the period of the numerator, considering the totality of the government's obligations during the years in which the salary supplements are given, so industrial peace will continuously prevail in the civil sector.
-  It is recommended that the CSC formulate a suitable tool to calculate salary ranges in tenders, publish them, and complete analyzing the occupations of the jobs in the government bodies.
-  The Salary Division should ensure that the incentive pay methods it employs are periodically updated, incorporate indicators from the civil service, and are effective in their contribution to increasing productivity and efficiency.
-  It is recommended that the Salary Division, in collaboration with the ministries where the differential reward is practiced, systematically check the effectiveness of the methods for differential reward, including the distribution of the rewards in "rotation," and if necessary, update the methods in the units and ministries where the reward is implemented. It is further recommended that the Salary Division consider the findings of the effectiveness test when approving the use of differential compensation reward methods in other units and ministries.
-  It is recommended that the Salary Division and the CSC, as two executive branches of the government, coordinate and share information, establish rules regarding double differential reward and prevent giving an employee ranked in a medium or low-quality group a reward for excellence, and apply them to all ministries, this, when considering efficient use of the tool and public resources.
-  It is recommended that the CSC, in consultation with the Ministry of Finance, define what operational on-call is and when it is needed and formulate binding standards for the assignment of on-call, considering the governmental body tasks and the situations that require employees to be placed on-call qualifying them for financial rewards. It is recommended to establish all of these in binding rules, for example, in the provisions of the Civil Service Regulations, and to monitor the ministries' compliance.
-  It is recommended that the Ministry of Finance include in the government salary policy the goal of the Salary Division and the recommendation of the team for examining the training structure in the civil service – to cancel the reward for continued education in the civil service and to untie the connection between a direct salary benefit and participation in training and formulate alternative encouraging managers and employees to study and participate in training activities throughout their employment time.



-  It is recommended that the Ministry of Finance change the method of rewarding civil service employees for private vehicle allowance to reduce the use of private cars and road congestion. If the action meets opposition from any government ministries or the IDF, it is recommended to bring it to the government's decision.
-  It is recommended that the CSC and the Salary Division determine a similar salary for employees in each national occupation in the ministries where employees do similar work. This encourages recruiting quality employees for all ministries and allows for more effortless employee mobility.
-  The disputes between the Ministry of Finance and the IDF about specific salary components in the IDF and the extent of government spending over it require examination, decision-making, and implementation, and if necessary, bringing the dispute before the government for a decision. The responsibility for this rests upon the Accountant General Division, with the assistance of the Salary Division if necessary, and upon the Ministry of Defense and the IDF.



The Number of Jobs in the Civil Service, the Expenditure on Salary, and Their Rate out of the Total Number of Jobs and Salaries in the Civil Service, by Types of Entities, 2019 (in NIS Billions and Percentages)



According to the Salary Division report on public entities and the Salary Division report on government entities, 2019, processed by the State Comptroller's Office.



Summary

This audit report presents deficiencies in the management of salaries and employment in the civil service in several aspects: the strategic aspect – the government did not formulate or approve a government salary policy; The individual aspect of the salary components – the salary in the civil service includes hundreds of salary supplements and components that are no longer applied according to their original purpose and mechanisms to reward and motivate employees whose effectiveness is questionable; The equality between employees and between bodies – in the civil service, and at least in the national occupations in which the principle of paying similar salaries for work of similar value is not preserved, may harm the ability of ministries to improve the service they provide to the public due to the relatively low salaries. The report also presents salary linkages and wide-ranging consequences, especially defense system salaries, whose manner of application increased the disparity between the salaries of those serving in the IDF, the police, and the Prison Service and the salaries of civil servants; The financing aspect of the salary supplement – the government signed a framework agreement in April 2016 and allocated funds for its realization not according to the principle underlying the numerator, and as a result was forced to allocate hundreds of millions of additional NIS to finance the agreement.

The findings of the audit and the data underlying them emphasize the need for the government to establish a comprehensive policy on employment and salaries in the civil service system and implement it.



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Chapter Two

Government Ministries



Report of the State Comptroller of Israel |
November 2022

Ministry of Finance

Government Vehicle Administration



Government Vehicle Administration

Background

The Government Vehicle Administration (the Vehicle Administration or the Administration) is a unit in the Assets, Procurement, and Logistics Division of the Accountant General's Department of the Ministry of Finance (the Accountant General). It provides vehicle services to all government ministries and their auxiliary units. The Vehicle Administration budget is based on budgetary participation from the government ministries. It is designated for four expenses: vehicle purchase, vehicle maintenance, insurance, and Administration's overhead – administrative expenses. According to the Administration's financial statements, in 2021, the Administration's expenses were NIS 178 million, and the government vehicle fleet was about 5,100 vehicles, which about 12,000 drivers are authorized to drive. The Assignment Committee, headed by the Accountant General or someone on his behalf, assigns vehicles to officeholders in a government ministry¹.

1 The committee members are: Senior Deputy to the Accountant General, Director of the Assets and Logistics Division (acting chairman), Senior Deputy of the Accountant General, Director of the Wages and Service Conditions Division Director of the Government Vehicle Administration, Deputy Budgets Commissioner or his representative.



Key Figures

**NIS 226
million**

the annual average of the Vehicle Administration's expenses in 2011–2021, according to the financial statements

40%

of the active vehicles' age exceeds the vehicle age model set by the Administration (more than 2,000 vehicles out of approximately 5,200 active vehicles)²

**over NIS
500
million**

the one-time potential income from the transition of the passenger vehicle fleet to the leasing method. The finance sources are the sale of the state's fleet of passenger vehicles, the transfer of the Renewal Fund funds accrued in respect thereof to the State Treasury, and the reduction of the airbags at Inbal Insurance Company Ltd.

**about NIS
6 million**

the State Comptroller's Office estimation of the potential annual financial savings between the Vehicle Administration method and the leasing alternative due to the service improvement and the vehicles³ age reduction

2 According to the data of the Merkava system (a comprehensive trans-organizational system in government ministries) as of January 2022, the Vehicle Administration has approximately 5,200 active vehicles, of which approximately 1,000 are prison service vehicles that are purchased and sold by the Administration, but are not maintained by it.

3 Based on a conservative assumption that the average age of the Administration's vehicles is 2 years, not 5 years (average age of active passenger vehicles, as of January 2022).



**only 3
vehicle
safety
officers**

responsible for about 4,500 vehicles used by about 12,000 drivers, including about 480 buses and heavy and medium trucks. In 2018–2021, the Administration did not perform annual safety and standardization audits

**NIS 371
million**

the unexplained difference, as of January 2022, between the existing capital in the Renewal Fund⁴ (according to the financial statements) and the Fund's commitments to the government ministries (according to the data of the Merkava system)


**2.6 and
2.9
(out of 5)**

areas where the ministries' satisfaction is the lowest, according to the satisfaction questionnaire sent by the State Comptroller's Office. Regarding the time required to receive a response from the Assignment Committee and for the transparency and clarity of the budget accounting (respectively)

**NIS
246,000**

total fines for 202 traffic reports given to government vehicles not assigned to the drivers who committed the offenses and paid by the government ministries (in 2019–2021)

Audit Actions

 From April 2021 to January 2022, the State Comptroller's Office examined the management and operation of the government vehicle fleet, mainly at the Vehicle Administration in the Accountant General Department. Completion examinations were conducted at the Inbal Company, the Government Housing Administration in the Accountant General Department, the Budgets Division at the Ministry of Finance, and the National Fire and Rescue Authority. Furthermore, questionnaires were sent to 35 government ministries.

⁴ The Renewal Fund was established by the Accountant General in 2011, and its purpose is to accumulate funds received from government ministries before the actual purchase of the vehicles and to purchase and renew vehicles with funds that are outside the budget. The amount of the annual charge is equal to about 25% of the value of the vehicle net of the value of the scrap value at the end of four years from the date of its purchase.



Key Findings



Waiting Time for the Assignment Committee Discussions – the Assignment Committee is appointed by the Minister of Finance to discuss the criteria for assigning vehicles to government officials and approve them. In 2018–2021, the Committee received an average of 450 appeals each year, and the waiting days for their discussions are rising and reaching an average of 56 days in 2021. A negative correlation was found between the number of Committee meetings per year and the waiting days for the discussion. The Assignment Committee does not increase the number of meetings to adapt to the number of pending applications or the ministries' waiting time for their discussion.



Comparison Between the State's Payment Expenses for State Employees Vehicle Allowance and the Cost of the Vehicles in the Vehicle Administration – the Assignment Committee does not compare the cost of providing assigned vehicles to state employees versus the alternative of vehicle allowance cost in the employees' wages. Although, in each service level, particularly the higher service levels (3rd and 4th), some vehicles whose monthly cost is lower over NIS 1,000 per month than the cost of vehicle allowance component in the wage.



The Age of the Administration's Vehicles – the Vehicle Administration vehicle fleet is mainly old. Over 2,000 vehicles (about 40% of the active vehicles) should be replaced so the age of the vehicles will meet the desired age set by the Administration. The average age of all Administration vehicles, as of January 2022, is six years (the average age of passenger vehicles is five years⁵). Moreover, about 200 vehicles are relatively new but have traveled over 200,000 km.



Electric Vehicles – the Vehicle Administration active passenger vehicle fleet is based on polluting vehicles, and 75% of the passenger vehicles are not hybrid or electric. Furthermore, only six charging stations for electric vehicles are installed at the government ministries, making it difficult to fully meet the government resolutions to transit to electric vehicles as of 2025.







Safety – since 2018, the Vehicle Administration has not carried out safety examinations in the government ministries, did not investigate traffic accidents committed in the Administration's vehicles, did not collect a damage deductible due to negligent driving, and has not examined complaints due to unusual driving. At the audit completion, three


5 Had the turnover of the passenger vehicles been carried out in accordance with the Vehicle Administration's vehicle replacement model, every 4 years, the average age of the passenger vehicles would be 2 years and not the actual average of 5 years.



safety officers were employed in the Vehicle Administration. The Administration did not appoint 9 vehicle officers under the Ministry of Transport and Road Safety guidelines from April to May 2021. As a result, the three vehicle officers are responsible for about 4,500 vehicles used by about 12,000 drivers, including about 480 buses and heavy and medium trucks.

-  **Vehicle Maintenance** – by the State Comptroller's questionnaire, the satisfaction level of the government ministries and drivers with the service quality of the service center and the maintenance work at the garages was 3.5 (out of 5). Furthermore, although the Vehicle Administration has been working since 2018 to establish a service level agreement with Inbal and the garages, thus far, no binding agreement has been settled between them, including service norms in vehicle maintenance and accident repair.
-  **Sale of Vehicles** – in 2018–2020, 3,411 vehicles were sold to 535 buyers through the Vehicle Administration tenders, at about NIS 138 million, i.e., about NIS 40,000 per vehicle on average. It was found that vehicle dealers purchased 92% of the vehicles, and 16 large dealers (3% of the total bidders) purchased 34% of the vehicles. Furthermore, 64% of the sales were at prices lower by 70% than the price list, and 15% of the sales were at prices lower by 50% than the price list. Thus, even after a reduction of 30% from the price list of government vehicles (compared to the price list customary in the market), the selling price of these vehicles is lower than the price list relevant to government vehicles.
-  **Purchase of Vehicles (Renewal Fund)** – by the Merkava system records, the ministries' credit balance in the Renewal Fund as of January 2022 is about NIS 516 million. However, by the financial statements, the ministries' credit balance in the Renewal Fund is about NIS 145 million, plus NIS 100 million, which was transferred in 2017 to the Budget Division according to the budgetary agreement – and in total, NIS 245 million. I.e., there is a difference of About NIS 371 million between the data held in the Merkava system and the data in the financial statements. Furthermore, the withdrawal in favor of the Budget Division at NIS 100 million, which was anchored in a budgetary agreement from 2018 signed by the Budget Division and the Accountant General Department, fundamentally changes the financing method of the vehicles purchase. Thus, it creates a dependency on the state budget and is inconsistent with the Chief Accountant's order from 2011, according to which the funds accrued in the Renewal Fund should not be transferred for other purposes.
-  **Pooling Vehicles** – pooling vehicles are used by government ministries only on their operation days and are not assigned to one person. As of January 2022, there are 1,161 passenger-type pooling vehicles, and their annual cost is about NIS 32 million per year. 48% of pooling vehicles examined by the Audit Division of the Accountant General Department, have savings potential by transitioning to a daily rental method. The maximum savings rate for this transition is estimated at 21% of the expenses on the pooling vehicles (about NIS 6.8 million in annual savings).






 **Economic Examinations of the Leasing Alternative** – the Vehicle Administration and the Accountant General Department conducted economic tests examining the viability of the leasing alternative based on assumptions that do not correspond with reality. For example, costs to the leasing companies of about NIS 3,000 per year per vehicle (about NIS 250 per month) were unnecessarily added, and services at about NIS 14,000 per year (approximately NIS 1,150 per month) provided by the leasing companies only, were not incorporated. By the State Comptroller's Office cost comparison, including the service comparison, the Vehicle Administration cost is about 10% higher than the cost of the leasing alternative.






Transition to the Tender Method – under the shortcomings that the Administration identified in the tender method for purchasing vehicles, and to shorten the procurement processes and increase competitiveness in the tenders, the Administration published a new tender in 2021 for the purchase of vehicles using the tender method. However, the work procedure on the subject has not yet been updated.

Key Recommendations

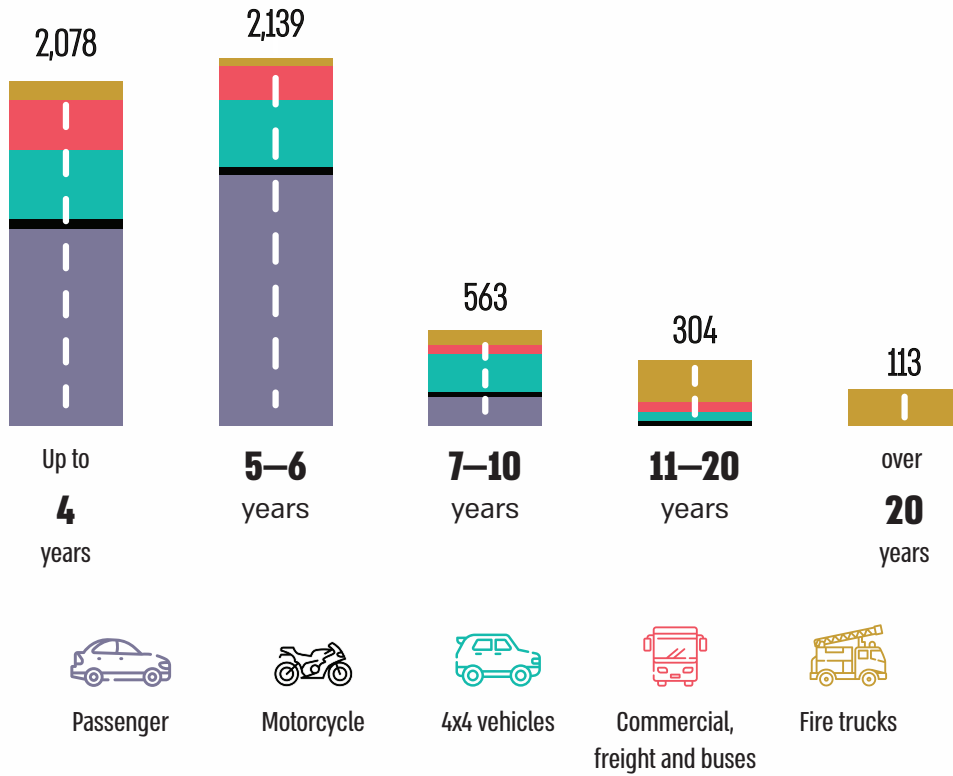
-  It is recommended that the Accountant General Department consider formulating a comprehensive policy regarding the extent of public sector employees' use of private vehicles, encouraging the transition of public sector employees to public transportation and reducing travel on the country's roads. It is further recommended that the Assignment Committee set reasonable waiting time for discussing a request and adapt the frequency of its meetings to the appeals waiting for a Committee hearing and the length of waiting time for the appeals hearing in the Committee.
-  It is recommended that the Vehicle Administration prepare organizationally and budgetarily to purchase and deliver new vehicles to the extent required to refresh the vehicle fleet according to the desired vehicle age model. Thus, implement the government resolution to transition to non-polluting vehicles and electric vehicles.
-  It is recommended that the Housing Administration promote the establishment of electric charging stations in government ministries in a scope that will support the increase in the number of electric vehicles in the government fleet. Given the current difficulties in setting up charging stations, it is recommended that the Vehicle Administration, in cooperation with the Ministry of Energy, examine the conditions for allocating electric vehicles to entitled employees and implement the government resolution to entirely transition to electric vehicles from 2025.



-  The Vehicle Administration should audit safety and standardization in the ministries as part of its routine work plan and according to the Finance and Economy Regulations provisions to optimize the government vehicles' competence and contribute to their driving safety. In addition, the Vehicle Administration should recruit safety officers and investigate accidents involving Administration vehicles.
-  It is recommended that the Vehicle Administration and the Budget Division examine the reasons for creating surpluses in the Renewal Fund. Whether the funds' source is from the ministries' over-collection or a temporary surplus due to partially implementing the replacement program model. In addition, it is recommended that the Vehicle Administration and the Budget Division ensure that these funds are used for the intended purpose – renewal of vehicles – according to the Chief Accountant's instructions.
-  It is recommended that the Accountant General Department and the Vehicle Administration re-examine the leasing alternative based on calculations and assumptions consistent with the existing data and the actual situation, considering the types of vehicles feasible for such a model. Consider a partial or full transition to the leasing model, depending on the examination results.



The Number of the Vehicle Administration's Active Vehicles, According to the Vehicle's Age and Type January 2022



According to the Vehicle Administration data (including prison service vehicles), processed by the State Comptroller's Office.



Summary

Deficiencies were raised regarding the Government Vehicle Administration, responsible for providing vehicle services to government ministries. Regarding the government vehicle fleet, which includes about 4,500 active vehicles, there is a considerable deviation from the government resolution regarding the desired age of the vehicles, and that the vehicle fleet is based on polluting vehicles. Moreover, the provisions of the Finance and Economy Regulations of safety, standardization, and budget management are not implemented, resulting in high financial costs that can be saved. The Vehicle Administration should improve the operation of the vehicle fleet, including compliance with the established vehicle age model; Improve the sales mechanism; and supervise and control the vehicle fleet and the drivers authorized to drive it. It is also recommended that the Administration incorporate electric vehicles in its vehicle fleet and consider alternatives to manage the vehicle fleet, including transition to the leasing method. This includes cost savings and improving the quality of active vehicles and the quality of service given to drivers.



Report of the State Comptroller of Israel |
November 2022

Israel Tax Authority

The Public Service at the Tax Authority – Extended Follow-up Audit




The Public Service at the Tax Authority – Extended Follow-up Audit

Background

The Israel Tax Authority (the Tax Authority or the Authority) collects government taxes from most of the residents and business entities in the country. Hence, the quality of the service it provides them is essential. The service quality of the taxpayers' interfaces with the Authority, including the information given to the taxpayers on their rights, has a substantial impact on both the efficiency of tax collection and the rate of tax benefit exhaustion. The Tax Authority, like any public authority, is designed to serve the public in an efficient, equitable, and high-quality manner. The organizational vision of the Authority states: "The Tax Authority will work effectively to enforce the collection of taxes and to provide an efficient, quality, and fair service".

Audit Actions

 The State Comptroller's audit report from 2015 on the exhaustion of tax benefits and public service at the Tax Authority (the Previous Audit) dealt, among other things, with the service to the taxpayer. From August 2021 to February 2022, the State Comptroller's Office examined the Tax Authority's actions to improve the service and rectify the deficiencies noted in the Previous Audit. Furthermore, the examination was expanded and focused on small businesses, the Income Tax Service Centers (ITSC), and import and export customs services.



Follow-up of the Rectification of the Deficiencies Noted in the Previous Audit

Key Figures

**14:41
minutes**

the average waiting time for a remote appointment with the assessment offices, by the online system

200,823

calls were received at the Tax Authority's Call Center from September to November 2021

**only
0.08%**

the phone quality control rate performed over calls at the Call Center from September to November 2021 (164 out of 200,823 calls)

10,916

applications for tax exemption due to disability submitted to the Income Tax in 2021

Key Findings




Reception Hours – the previous audit raised that the reception hours at the assessment offices are usually on Sunday until Thursday, in the morning, at 8:30–13:00. In the assessment offices (where there are teams processing tax returns and tax coordination), reception hours on Mondays and Wednesdays are also in the afternoon hours. Assessment offices serve taxpayers' in these reception hours. Since the reception hours in the assessment offices are usually in the morning and in a limited way in the afternoon hours, many taxpayers are forced to be absent from work to receive these services. By the follow-up findings, the deficiency was not rectified. The reception hours in the offices have been reduced, as the reception hours on Sundays and Tuesdays have been canceled. Thus, fewer days and hours are allocated to those who need assistance and a meeting with the employees of the assessment office.




Duration of Waiting Time for Service – the previous audit noted assessment offices with routinely long waiting time and taxpayers waiting for service for hours. The follow-up audit raised that the deficiencies have been slightly rectified. According to the Tax Authority data, from January to September 2021, the average waiting time at the assessment and land taxation offices was 17:01 minutes. From the beginning of October



2021, the Authority's online system for remotely scheduling appointments was introduced. This system enabled shortening the waiting times, and from October to December 2021, the waiting time at the assessment offices was 14:41 minutes. However, the reception of only those who scheduled an online appointment harms those who do not use the internet (people who avoid it for religious reasons, elderly people who are not skilled in using the internet or those who do not have the infrastructure to connect to the internet).

 **The Phone Response Quality** – from June 2020, the Tax Authority began to operate, through outsourcing, a national phone call center that responds to various tax systems inquiries. The Tax Authority employees listen to responses to dozens of inquiries every week, grade them, and determine the quality of the response. Still, they do not base the grade on a defined list of components or clarify how the grade is determined. It was also found that quality control was performed over 164 calls out of 200,823 incoming calls from September to November 2021, about 0.08% of the incoming calls, and that the rate of calls that the Tax Authority graded as a good response in that period was 52%. Therefore, half of the applicants did not receive a quality response as defined by the Tax Authority.

 **Provision of Information, Training, and Forms in Languages Other than Hebrew** – Language Accessibility – the previous audit raised that the information brochures and forms in the assessment offices and land taxation offices are in Hebrew only, except for an explanatory brochure on income grant (negative income tax). The follow-up audit raised that the deficiency has not been rectified and that in Umm al-Fahm Intelligent Transformation System centers (ITSC) for the Arab population, there are no explanatory booklets or forms in Arabic. Moreover, the queue management system and the digital display inviting applicants to the Tax Authority representative are managed and displayed in Hebrew.



Service at the Assessment Offices – the State Comptroller's Office stated in the previous audit that government offices should serve every citizen on their arrival day. The follow-up audit raised that the deficiency has been fully rectified. In the followed-up offices, all the applicants received the service on their arrival day, and the reception lasted until the queue's end.





Phone Response by the Assessment Offices – the previous audit raised that the assessment offices have no computerized control mechanisms for phone responses, and there was no uniformity in the recordings on the call router in all the assessment offices. It was also found that in many cases, the call router of the phone answering service in the assessment offices is not updated, and sometimes it forwards the phone calls to extensions that are not staffed. The follow-up audit raised that the deficiencies have been largely rectified. In June 2020, the Tax Authority began to operate, through outsourcing, a national phone call center that responds to inquiries about various tax



systems. The call center operates from 8:15 a.m. to 3:30 p.m., Sunday through Thursday. This is in two shifts, each of which employs about 90 workers.

Taxpayers Appearing Before the Medical Committees of the National Insurance Institute – the previous audit raised that each taxpayer must appear before over three medical committees on average for the medical diagnosis and for decision making in his case. The follow-up audit raised that the deficiency has been fully rectified. Currently, people with disabilities can send all documents online to the medical committee. The committee discusses their application according to the documents they sent, and they are not required to attend the committee's deliberations.

Key Recommendations

-  **Reception Hours** – it is recommended that the Tax Authority consider increasing the number of reception days and hours at the assessment offices, also for those requiring service beyond the delivery of documents, to provide a better and more convenient service to taxpayers.
-  **Duration of Waiting Time to Receive Service** – it is recommended that the Authority consider ways to further shorten the waiting times in the offices. Moreover, to instruct them to accept those who arrived without an appointment online scheduled in advance, to schedule an appointment online through a scheduling system, to be placed in the assessment offices, or to accept them in available time slots.
-  **The Phone Response Quality at the Assessment Offices** – it is recommended that the Tax Authority examine the cases, which did not receive a proper response, and the reasons for this, and according to the examination findings, improve the quality of the service provided in the call center. It is further recommended that the Tax Authority examine the scope of call quality control as required and expand it.
-  **Provision of Information, Training, and Forms in Languages Other than Hebrew** – Language Accessibility – the Authority should consider language accessibility for non-Hebrew speaking populations and make rights and services accessible in the various required languages.



Additional Issues Examined in the Extended Audit Regarding the Service to the Taxpayer at the Tax Authority

Key Figures

NIS 6.89 billion

credit balances of taxpayers obligated to report awaiting approval for reimbursement, as of January 2022, of which NIS 3.23 billion are awaiting approval for over 90 days

9,213 citizens

contacted the Ashdod service center in 2021. Of these, 134 left without receiving service. The average waiting time for service was 10:56 minutes

about 73,000 self-employed

registered as exempt self-employed (whose income is up to NIS 100,000), of which, in 2017–2020, only about 1.5% of those whose annual income is up to NIS 60,000 exhausted the relief possibility in the annual reporting to the Tax Authority

24 assessment offices

out of 25 do not meet all the requirements of the Equal Rights Law regarding accessibility to the office

503,188 applications

for an aid grant for self-employed and companies by participation in fixed expenses were submitted to the Tax Authority from March 2020 to December 2021. In 968 (0.2%) of them, the processing was not completed until March 2022

70 inquiries

referred to the assessment offices by the online inquiries system in June 2021 were reviewed by the audit team. It was found that 48 (about 69%) of the applicants did not receive a response and were required to complete additional documents and reapply to receive their requested service


Key Findings





Tax Refunds for Employees and Individuals not Required to Report – the audit raised that in 2020 – 113,441 employees and individuals who are not required to report submitted a report for a tax refund. Moreover, the Tax Authority does not have current





data on the credit balances scope it is supposed to refund them, on the number of those entitled to a refund and on the time that has passed since they applied for a refund until the refund is paid.

-  **Withholding Credit Balances Refund to Taxpayers** – according to the Tax Authority data, as of January 5, 2022, the credit balances the Tax Authority disapproved to refund to taxpayers (required to report) were NIS 6.89 billion. The credit balances withheld for over 90 days were NIS 3.23 billion, of which NIS 2 billion are awaiting approval, and the Authority withholds the rest for assessment or collection reasons. Thus, according to the Tax Authority's data, as of January 2022 – 78,659 credit balances were not refunded due to a lack of bank account details, a total of NIS 479.9 million.




-  **The Handling Duration in the Public Inquiries System (MAPAL)** – it was raised that over the years, there has been considerable growth in applications at the public inquiries system. In 2021 (until December 5, 2021), 478,901 citizens contacted the assessment offices. Most assessment offices met the goal of providing the applicant with a response within 48 hours. However, in six assessment offices out of 25, the inquiries handling time in 2021 exceeded the goal set by the Authority, and each of them accumulated dozens of unanswered inquiries.

-  **Reporting on the Completion and Closing Inquiries on the Public Inquiries System** – it was raised that contrary to the Authority's directive, the employees handling inquiries report the completion of handling an inquiry not only when the inquiry has been resolved but also when the inquiry handling has not been completed. For example, when the applicant is required to supplement additional documents or even when the inquiry is referred to the care of another employee. It was also found that when the office employee closed an inquiry, even when its handling was not completed, the inquiry was deleted from the list of inquiries. Therefore, when the applicant sends the requested documents to the public inquiries system, the inquiry is reopened as a new inquiry, even though it is a follow-up to a previous inquiry.

-  **Physical Waiting Conditions in the Income Tax Service Centers (ITSC)** – it was raised that those waiting in a queue at some of the Income Tax Service Centers (for example, in Haifa and Tel Aviv) do not have adequate conditions for waiting in line, including seating. Furthermore, some of the Income Tax Service Centers (for example, in Netanya and Beer Sheva) do not have entrance lobbies to the building, and those waiting in queue wait outside, in an unsheltered place, exposed to the rain and sun in winter and summer.

-  **Taxpayers with an Income of up to NIS 60,000** – it was raised that in 2017–2020, out of about 60,000 small business owners, only about 1.5% exhausted the relief possibility in the annual reporting to the Tax Authority and submitted an abbreviated reporting form.




-  **The Online Service for Exporters at the Customs Administration** – it was raised that, unlike the import system that operates online in the "World Gateway" system, the export system does not operate online and not even through the "World Gateway" system. It was also raised that for each export entry, the customs agent is required to submit to the customs house a printed physical copy to which all the relevant documents are attached, including a copy of the certificate of origin, export account, export permits, export certificates and licenses, and any export document as required.
-  **Covid-19 Grants** – it was raised that the Authority paid aid grants by participation in fixed expenses of about NIS 1 billion, excess payments in about 25,000 cases. It was also raised that the Tax Authority has no data on the total scope of the required reimbursement of social grants given in excess. In any case, it cannot analyze and optimally perform the actions necessary to recoup them.
-  **Service Level Agreement (SLA)** – as of February 2022, the Tax Authority does not have a service level agreement (SLA) and has not published public service indices and goals.










Refunding Credit Balances to Taxpayers – the Authority has taken several measures to facilitate refunding credit balances. For example, in the 2020 tax year, the Authority increased the amount of the credit balance automatically refunded. In four automatic refunds made in 2020–2022, NIS 522.9 million was refunded in 7,511 cases.

Integrated Office of the Sharon Region Tax Authority – the Tax Authority established the Sharon Region Tax Authority office in 2021. The integrated office consolidates similar activities carried out in both arrays (income tax and VAT) to streamline the work, improve the use of knowledge between the two tax arrays, increase the effectiveness of tax collection, and improve the service provided to self-employed and taxpayers alike.

Key Recommendations


-  **Tax Refunds for Employees and Individuals not Required to Report** – it is recommended that the Tax Authority develop a mechanism enabling ongoing monitoring of the submitted reports for refunding excess tax paid by employees and individuals who are not required to report. It is further recommended that the Ministry of Finance, in coordination with the Tax Authority, consider implementing the declarative reporting model in Israel, partly through learning and concluding from implementing this model around the world.




-  **Withholding the Refunding of Credit Balances to Taxpayers** – it is recommended that the Tax Authority examine why the refund of credit balances has been withheld longer than stipulated in the Income Tax Ordinance and refund the balances if no relevant reason for withholding is found.
-  **The Handling Duration in the Public Inquiries System (MAPAL)** – it is recommended that the Tax Authority examine the reasons for the delays created in some of the offices and ensure that all the assessment offices meet the target it has set to prevent the accumulation of numerous inquiries not answered within 48 hours.
-  **Completion of Handling by the Public Inquiries System** – it is recommended that the Tax Authority update its instructions to the assessment offices to close an inquiry in the public inquiries system only upon completion of its handling and that every inquiry will undergo an initial examination. In a previous inquiry case, the inquiry will be routed accordingly in the public inquiries system, and will be handled if possible by the initial party that handled it before. As for applicants who were asked to provide additional documents, it is recommended that, the public inquiries system will alert a few days later about the need to supplement the required documents and, if necessary, issue an automatic reminder to the applicant.
-  **Physical Waiting Conditions in the Income Tax Service Centers (ITSC)** – it is recommended that the Tax Authority examine the conditions provided to those waiting in a queue at the Income Tax Service Centers and provide suitable conditions for waiting in line, such as seats and shelter.
-  **Income Tax Service Centers in the Arab Sector** – Umm Al-Fahm – it is recommended that the Tax Authority consider preparing information brochures and forms in Arabic for the population requiring it and act accordingly. It is also recommended that the Authority utilize the Income Tax Service Center location near the local population's residence to introduce its rights and help it exercise them. It is also recommended that the Tax Authority draw the lessons from establishing the Income Tax Service Center in Umm al-Fahm and consider establishing Income Tax Service Centers for the Arabic-speaking population in the south of the country. It is also recommended that the Tax Authority consider establishing Income Tax Service Centers for additional unique populations with unique needs, such as the ultra-Orthodox population in Bnei Brak.
-  **Taxpayers with an Income of up to NIS 60,000** – it is recommended that the Tax Authority examine the reasons for not responding to those entitled to an abbreviated report and introduce them to this option. This will reduce the burden imposed on the Tax Authority in handling these taxpayers and may improve the quality of service to the public at large. It is also recommended to consider alternatives to the required reports of these populations.
-  **The Online Service for Exporters at the Customs Administration** – it is recommended that the Tax Authority promote the execution of export activity through the



"World Gateway" system so exporters can submit documents online. It is also recommended that until then, the Authority will consider adopting the system operating at the Jordan River Customs House in other customs houses.

 **Covid-19 Grants** – it is recommended that the Tax Authority management gather the data of the various Covid-19 grants and monitor and ensure that all grants given in excess are collected by it.

 **Service Charter** – it is recommended that the Tax Authority determine a SLA, publish it and comply with the schedule established by the Government Service Improvement Bureau at the ICT Authority. Furthermore, it is recommended that the Authority regularly update its service charter upon examination of the realization of the service goals.

The Waiting Area in the Entrance Lobby at the Beer Sheva Tax Office is not Fully Sheltered and is Exposed to the Elements



Photographed by the audit team.



The Extent of the Rectification of Key Deficiencies Noted in the Previous Audit

The Audit Chapter	The Audited Body	The Deficiency/ Recommendation in the Previous Audit	The Rectification Extent of the Deficiency in the Follow-up Audit			
			Not Rectified	Slightly Rectified	Considerably Rectified	Completely Rectified
Service to the taxpayer in the assessment offices	The Israel Tax Authority	Since reception hours in the assessment offices are mainly in the morning and in a limited way in the afternoon, many taxpayers are forced to be absent from work to receive these services.				
		Some of the audited assessment offices do not provide service to all taxpayers who arrive during reception hours, so the taxpayers are forced to come once more to receive the service.				
		In some Assessment offices, waiting times are routinely long, and taxpayers are forced to wait there for hours to receive the service.				
		The assessment offices have no computerized control and supervision mechanisms for phone call centers. Furthermore, there is no uniform recording of the call routing system in all the assessment offices.				
Providing information, training, and forms in foreign languages – linguistic accessibility	The Israel Tax Authority	The information brochures and forms in the assessment offices and land taxation offices are in Hebrew only, except for an explanatory leaflet on the income grant (negative income tax).				



The Audit Chapter	The Audited Body	The Deficiency/ Recommendation in the Previous Audit	The Rectification Extent of the Deficiency in the Follow-up Audit			
			Not Rectified	Slightly Rectified	Considerably Rectified	Completely Rectified
The service for people with disabilities and blind people in the assessment offices	The Israel Tax Authority	A person with disability applying for tax exemption is required to come to the assessment office at least five times physically.				
		A taxpayer who wishes to undergo a medical examination by the National Insurance Institute to receive an exemption from income tax due to his disability must pay a fee.				
		It is impossible to file a claim for a tax exemption for a person with disability on the Tax Authority's website.				
		To execute an exemption that has already been granted by the National Insurance Institute, a person with disability must reach the assessment office and fill out an exemption application form, and attach the protocol of the aforementioned medical committee. Thus, the Authority imposes an unnecessary bureaucratic burden on those who have already been examined by medical committees – submitting medical documents supporting the tax exemption application.				
		A taxpayer must appear, on average, in over three medical committees for the medical diagnosis and decision-making in his case.				



The Audit Chapter	The Audited Body	The Deficiency/ Recommendation in the Previous Audit	The Rectification Extent of the Deficiency in the Follow-up Audit			
			Not Rectified	Slightly Rectified	Considerably Rectified	Completely Rectified
		The Authority does not send the protocol to the person with disability; he must physically come to the assessment office to photocopy the medical committee protocol.				
		The Authority does not inform the persons with disability entitled to the tax exemption of the time limit for submitting the reports for a tax refund.				
		The Tax Authority should join the National Insurance Institute process for the mechanization of the medical committees to make it easier for the public with disability wishing to undergo a medical committee, to shorten the procedure time, and to make it easier for them to face bureaucratic barriers.				
		A certificate of blindness bears two dates: the date the certificate was issued and the expire date. To receive the benefits of a blind person, they should submit a copy of their certificate of blindness. They are entitled to these benefits from the date their eligibility was established, but this date does not appear on the certificate.				



Summary

The Israel Tax Authority is responsible for collecting government taxes, and it works with most of the residents and business entities in the country. Therefore, the quality of the service it provides them is essential. An optimal government service contributes to increasing the public's satisfaction, reducing the bureaucratic burden imposed on it, streamlining the work of the Tax Authority, and saving time and money resources.

The audit raised that the Tax Authority has rectified most of the deficiencies noted in the previous audit regarding the service to the citizen. In addition, the audit examined further public services and raised that the Authority is withholding credit balances of NIS 3.23 billion for over 90 days (the period established in the Income Tax Ordinance), among other things, for assessment or collection reasons, that gaps were found in the online public inquiries system operation, and that small businesses do not receive complete information regarding their entitled benefits, such as reducing the sum of advances and submitting an abbreviated report. In addition, the Tax Authority has not completed the preparation of a SLA detailing its goals and the extent of its commitment to provide efficient service and its indices and has not published this SLA to the public.

It is recommended that the Tax Authority improve the service by organization-wide planning, improve and upgrade the digital communication channels between it and the public and expand the set of independent actions that can be performed online while considering the general public and particularly small business owners. It is also recommended that the Tax Authority establish and publish a public service charter.



Report of the State Comptroller of Israel |
November 2022

Israel Tax Authority

Aspects of Effectiveness of the Tax System



Aspects of Effectiveness of the Tax System

Background

The tax system is intended to collect taxes from the country's residents to finance public services such as security, physical infrastructures, health, education, and welfare. According to the State of Israel's financial statements for 2020, the state revenues from taxes and fees this year were about NIS 389 billion, (about 79% of the state revenues for this year, about NIS 492 billion). Hence, the importance of the Israel Tax Authority (the Authority) is the tax collection enforcement from all sectors of the economy and initiating tax regulation according to economic developments, etc.

Key Figures

NIS 362 billion

state revenues from direct and indirect taxes (gross) in 2020

NIS 11 billion

the total cumulative expenditure by the tax authority in 2017–2020

NIS 67 billion

estimated tax benefits in 2019, which increased by 34% in 2015–2019

about NIS 18 billion

the additional tax in 2019 from income tax and VAT assessments, 11.5% of the total income tax and VAT this year (NIS 156 billion) compared to total tax collection of NIS 310 billion

1.185 million reports

were submitted by self-employed persons, companies, employees, and public institutions obligated to report to the Tax Authority in 2020, compared to about 692,000 reports in 2012 (an increase of about 71%)

97% of the closed tax assessments

by the Tax Authority based on a taxpayer's declaration (45%) and assessments in agreement (52%) as of 2019



26 tax cases

in the scope of NIS 24.4 billion are pending in legal tribunals as of June 2021

700 investigation cases

(About 40%) out of 1,800 investigation cases awaited 3 years or more for legal hearings as of January 2019

843 applications for "ransom"

were submitted to the Tax Authority by taxpayers and self-employed who evaded taxes in 2016–2018

NIS 96 billion

the "tax gap" estimate – the Value Added Tax that the Tax Authority did not collect in 2008–2019


NIS 998 million

the taxes paid by 168 diamond dealers according to voluntary disclosure agreements in 2017–2019

23,070 citizens

(12%) out of the 197,314 did not respond to the Authority's letters as part of a campaign to expand the reporting network in 2014–2021

Audit Actions

-  From May 2021 to January 2022, the State Comptroller's Office examined the efficiency and effectiveness of the tax system. The audit was conducted at the Tax Authority. A supplementary audit was conducted in the Ministry of Finance, the Chief Economist's Division, the Ministry of Justice, and the Courts Administration.



Key Findings



The Complexity of the Tax System and of the Tax System's Performance Measurement

The Complexity of the Tax System – the tax system in Israel is complex and includes comprehensive legislation¹, and over the years, many amendments have been made thereto. Moreover, many regulations were promulgated to implement these laws. In addition, the Tax Authority publishes guidelines and circulars to its taxpayers and even makes individual taxation decisions. Due to these and other countries tax laws affecting Israel's taxation, there is also some ambiguity in matters previously regulated by law. It was found that there is no government body to carry out systematic staff work in preparation for the enactment of tax reforms to examine the reform effects on the complicated tax system, on the taxpayer compliance costs, on the computing adjustments costs, and the administrative preparation the reform requires (for example, preparation of additional forms and their computerization). Moreover, the tax laws did not undergo organization, collation, and simplification and were not adapted to the current situation (codification), despite the following: (a) the extensive changes made in the tax law reforms in recent years; (b) the complexity of the tax laws; (c) the multiple preliminary decisions, directives, and circulars; (d) the changes in the tax laws of other countries affecting the tax laws in Israel; (e) the ambiguity of previous legislation, case law, and the Authority's position.

The Effectiveness Level of the Tax Systems in Israel in an International Comparison – by the Tax Foundation Organization² from October 2021, ranking the competitiveness level of the tax systems in the 37 OECD member states, in the State of Israel, there was the most significant improvement in this ranking compared to the previous ranking published in 2020 (from 27th to the 14th). Moreover, Israel is ranked 17th in terms of corporate tax, 12th place in terms of VAT, and 10th place in terms of land taxes and customs. However, it was found that Israel is in 29th place in terms of the individual's tax, and its tax system has vulnerabilities compared to other countries, manifested in filling out annual reporting forms for companies, in the Israel tax brackets system, and in the relatively small number of bilateral tax treaties Israel signed with reciprocating states.

It was further raised that in some indicators, the Tax Authority is ranked lower than the tax authorities in the OECD member states, affecting its efficiency in collecting taxes. For

1 The Income Tax Ordinance, the VAT Law, the Purchase Tax Law, The Customs Ordinance and more.

2 An international body conducting studies in collaboration with OECD representatives.



example: (a) A low rate of the Authority's employees handles large businesses – ranking 29 out of 38 OECD states; (b) A low rate of the Authority's employees is assigned to auditing or collection and enforcement of tax obligations – ranking 23; (c) A high rate of the Authority's costs concerning its tax collection – ranking 29. On the other hand, it was raised that some indicators were ranked relatively high compared to the OECD states. For example, according to the data for 2016–2017, the authority was ranked fifth in the number of audits it performs on every 100 active companies.

Measuring the Performance of the Tax Authority and Publishing it – the state's total revenue from direct and indirect taxes in 2019 was estimated at about NIS 310 billion. Of this income, the total tax collected was about NIS 55 billion, and the total VAT collected was about NIS 101 billion. The tax yield of the income tax assessment offices was about NIS 13 billion, about 24% of the income tax collected (without deductions and land taxes). The tax yield of the VAT offices was about NIS 4.9 billion, about 5% of the VAT collected. As a result, the tax increase in 2019 from income tax and VAT assessments was about NIS 18 billion, 11.5% of the total collection of income tax and VAT this year (NIS 156 billion), and this vis-a-vis a total collection from all tax assessments at NIS 310 billion.



It was raised that the Ministry of Finance in Israel publishes only the tax collection scope and the degree of compliance with tax forecasts, with no data on the Authority's work vis-à-vis the taxpayer. However, these data do not necessarily reflect the tax system's efficiency since 88.5% of the income tax and VAT collection is automatic by withholding, without the Tax Authority's involvement, and is mainly affected by macroeconomic data. It should be noted that the US Tax Authority examines its work and even publishes its examinations to the general public and decision-makers.

The Tax Assessment in Israel Compared to Other Countries – by the OECD comparison report (2021) between the tax authorities in 59 countries, the number of employees in the Tax Authority in Israel is high relative to the number of working-age residents (the working age population) compared to the average and median in the other countries surveyed. Thus, for example, in 2019, there was one authority employee for every 622 working-age residents, while in the other countries surveyed, the average was – one employee for every 1,652 residents, and the median was one employee for every 728 residents. Furthermore, between 2018 and 2019, their rate increased in Israel, while in the surveyed countries (the average and median), the number of tax authority employees for each working-age resident went down.



It was also raised that vis-a-vis the surveyed countries, the Israel Tax Authority allocates fewer inputs and means to the core activity – assessments, audits, and enforcement, compared to the surveyed countries. Thus, in 2019, the rate of employees assigned to enforcing tax collection operations was lower than the internationally accepted rates (7% in Israel compared to 12% on average). In addition, a lower rate of the Authority's



employees is assigned to audits in large businesses (in 2019 – 1.2% of all the Authority's employees against an average of 4.5% in the 50 countries surveyed).


-  **Promoting National Goals Through the Granting of Tax Benefits** – the state budget in recent years includes tax benefits of tens of billions of NIS. For example, in 2019, the benefits were about NIS 67 billion (such as benefits for pension savings and education funds, benefits under the Encouragement of Capital Investments Law, tax benefits on income from gambling, etc.), but no retrospective examination was conducted to verify if the various benefits were given to the population groups the legislator intended to, and if they fulfilled the goals set by the government. Many years ago, most of these tax benefits were added to the tax laws. Since then, no in-depth examination of their effectiveness in general and concerning other alternatives has been carried out.
-  **The Scope of the "Black" Economy** – alongside the legal economy that is reported to the tax authorities and the various authorities, there is an economy that is not reported, known as the "black economy." One of its main goals is to avoid paying taxes. By the International Monetary Fund report from 2018, the estimated average rate of the "black economy" in Israel in 1991–2015 was 22% of GDP. It was raised that the Tax Authority and the enforcement bodies do not routinely publish activity estimates in the various illegal economic sectors. Therefore, it is impossible to analyze the effectiveness of the collaboration scopes between the tax authorities and the other enforcement bodies in each black economy hub.


The Efficacy of the Tax Authority's Activity


-  **The Location of the Regional Assessment Offices** – in 2019, the income tax assessment offices examined about 17 thousand tax files of self-employed persons, companies, managers, and employees. There is a gap between the physical location of the offices, almost all established decades ago, and between the commercial and industrial areas that were developed in the country since then, especially in the country's center. About two-thirds of the assessment files examined are concentrated in 12 specific assessment offices (mainly in the central region) out of 26 (including the integrated office).
-  **The Results of the Examination of Income Tax Report Assessments** – in 2019, the Tax Authority assessment offices collected about NIS 15.1 billion, mostly from assessments according to the taxpayer's declaration or assessments in an agreement between the Authority and the taxpayer. It was found that the Tax Authority could not pinpoint the tax decrease or the tax additions in the various assessment stages for the same taxpayer since the Authority's data of each final assessment includes only the last assessment stage. For example, it is impossible to compare an assessment issued after an appeal was filed to the court as a tax agreement between the Authority and the



taxpayer, with the tax in the final assessment and the tax determined with respect thereto in each of the previous assessment stages.

 **Development of Separate Models for an Informed Selection of Cases for Assessment** – the primary key to optimize the assessment procedures is an informed selection of cases to handle in an assessment and the handling methods and the types of examinations required. This highlights the need to improve the quality of the Authority's data mining system. It was raised that the Authority did not formulate separate models for handling taxpayers according to their size, fields of activity, and characteristics to maximize the tax yield alongside strengthening the Authority's control and deterrence of all businesses in the economy.

 **The Assessment Offices' Handling of Headquarter and Field Files** – by the Authority's guidelines, "headquarter files" should constitute 20% of all the files handled by the offices. It was raised that the Tax Authority does not have data on the headquarter files dealt with in the assessment offices. It has no information on the extent to which the headquarter files met the objectives, the tax yield in the headquarter files vis-a-vis the field files, etc. It was also raised that the Authority has no data on the field files included in the work plan that were not handled.


 **The Reward Model in VAT Offices and Income Tax Offices to Optimize the Assessment Procedures** – a summary report of an organizational review prepared by an external consulting company included, among other things, recommendations for change in assessment and audit processes among income tax inspectors and auditors of accounts in the VAT offices. Following the report, it was decided to launch a preliminary study (pilot) in which the tax inspectors and auditors will gradually be introduced to professional activity according to the outline. During the pilot period, the construction of an updated compensation and incentive model began, including the conclusions of the consulting company and implementing the Authority's goals concerning professional activity through results and quality indicators. It was raised that from January 2016 to January 2020, for 4 years, the Tel Aviv office (number 5) employees received a maximum and fixed incentive pay (without measurement) at the rate of 25%. From September 2016 to January 2020, for over three years, the employees of the offices in Kfar Saba, Ramla, and Jerusalem (number 2) received a maximum and fixed incentive pay (without measurement) of 25%. In addition, the employees in the VAT offices who were added to the pilot according to the new method of reward model received from the date of their addition to the pilot until December 2021 a fixed premium at a maximum rate not related to the Authority management's goals and the results of their work.


It was further raised that a new reward model has not yet been determined and implemented in the Tel Aviv Large Enterprises Appraisal Office and the Haifa and Jerusalem Large Enterprises Appraisal Units, which are central to the financial scope of




the cases managed, the tax yield generated therefrom, and as of June 2022, these offices operate according to the old incentive pay model.

Administrative and Legal Procedures in Tax Cases

-  **Delay in Processing Tax Orders** – as of June 2021, 2,108 tax orders are being heard in legal tribunals, where the disputed income tax in civil legal proceedings was about NIS 28.1 billion, of which 26 tax cases are in cumulative tax of about NIS 24.4 billion, including NIS 6.9 billion of nine orders that were issued to a large company in Israel. It was raised that the Tax Authority does not have centralized data on the topics above, enabling it to monitor and control the process of the civil proceedings. For example, the orders issuing dates, the average duration of cases handled in each district court, and the number of cases in which there was an additional delay due to an additional appeal by the taxpayer to the Supreme Court. It was also raised that, as of the audit completion date, the Courts Administration added no positions for designated judges in tax cases in the Tel Aviv Magistrate's Court. A designated judge was added to the Central District Magistrate's Court, and accordingly, the concentration of tax cases with these judges has increased. A delay in processing tax orders of tens of billions of NIS over many years harms the state treasury and the Tax Authority's deterrence capability. It may even harm the ability to enforce court rulings – particularly when a taxable company terminate its activities over the years.





-  **Cases Awaiting a Decision by the Legal Bureau of the Tax Authority** – it was raised that, contrary to the Attorney General's directive to the government from 2010 to complete the processing of cases in periods of up to 24 months, depending on the seriousness of the offense, as of January 2019 about 700 cases out of 1,800 have been waiting for over three years.

-  **The Reasoning and Publication of the “Ransom” Procedure** – the ransom procedure is an alternative procedure to criminal law, which enables suspects in tax offenses to avoid a criminal procedure and the expected punishment upon its conclusion, by the payment of money. In 2016–2018, 843 taxpayers and self-employed submitted applications for ransom (746 applications were approved). The Tax Authority denied 97 applications, and in 55 of the cases, indictments were filed against the tax offenders, and 21 cases were closed due to lack of evidence. It was raised that the Authority does not publish detailed reasoning for the approved ransom arrangements, but a few short lines without a detailed explanation. It was also raised that there is a delay of about two years in publishing the decisions of the ransom committees. For example, the 2017 ransom committee collection of decisions was only published in November 2019; The ransom committee collection of decisions for 2018 was only published in March 2021. An examination of ten tax cases where ransom committee decisions were adopted raised that in five of them, the committee's published considerations were partial and did not include all of its deliberations. The publication did not match the committee's concerns in two other cases. Moreover, an examination of 50 publications of the ransom




committees' decisions in 2018 raised that in 37 cases, the rate of the ransom for transaction tax evasion offenses or illegal deduction of input tax offenses was between 20% and 30% of the offense sum, however, from the committee's reasoning, it was impossible to understand why in some cases different rates were set within and outside this range. It was also found that the notice sent by the Authority to the applicant about the denial of his application was not reasoned.

Operational Aspects of the Authority's Activity

-  **Computerized Assessment Audit File** – in 2015, the recommendations of an internal committee at the Authority, appointed to formulate an outline for developing a computerized audit file, were submitted. It was raised that the taxpayers' files were managed manually at the audit completion. The development of a computerized income tax audit file system began on January 1, 2019. As of January 2022, the development of about 64% of the project has been completed, and its completion date has been postponed to June 2023.
-  **Online Capital Declarations** – a capital declaration may serve the tax inspector as a critical control tool to select files for the work plan and for the assessment process. The examination is done by comparing capital declarations submitted several years apart, from which it is possible to learn whether the taxpayer's capital has increased reasonably, consistent with the reports he submitted in the annual tax returns. It was raised that the capital declarations examination procedure was done manually and that the "online declaration of capital" characterization document was prepared in 2015 but was not completed. It was also raised that the development of the system was included in the work plan of the Assessment Division and the Computerized Processing Service (Shaam) in 2016 but was not implemented over the years.
-  **Tax Collection in the Various Tax Departments** – it was raised that although all tax departments operate under the same legislative authority – the Taxes (Collection) Ordinance – the Tax Authority conducts an independent collection process for each of the tax systems: income tax, deductions, VAT, land taxation and customs, and that the taxpayer may receive several payment booklets at the same time: a booklet for income tax advances, a booklet for income tax deductions and a VAT booklet. It was also raised that the collection processes and payment arrangements in the various tax departments are made separately vis-à-vis the multiple offices.
-  **Merging the Regional Tax Offices to Improve Service and Tax Collection** – at the audit completion, about 20 years after the government decides on the merger of the activities of the "Customs and VAT Division, the Income Tax Commission [Division], and the Computerized Processing Service (Shaam)," the merger of the regional offices and the vision of "One Point of Service" is still far from being realized, and is different from what is customary in tax authorities in leading countries in the world. The departments



merged into one authority continue to operate separately in most operational aspects. No benefit is derived from the merger, neither in operational aspects nor in improving tax collection or service to the taxpayer and reducing the bureaucratic burden imposed on him due to duplicate procedures vis-à-vis the various tax systems. In addition, the Tax Authority is currently not pursuing further merging of the tax departments.



 **An Increase in the Number of those Obligated to Report Compared to a Decrease in the Number of Income Tax Inspectors and to Their Contribution to the Total Tax Collection** – it was raised that there was a constant increase (approximately 71%) in the number of those obligated to submit reports (excluding employees who are not obligated to report and submitted reports for tax refunds) from 691,827 in 2012 to 1,185,349 in 2020. For example, there was an increase of about 130% among the employees, 75.5% among self-employed, and 44.3% among companies. On the other hand, the number of income tax inspectors decreased by about 20.6% in 2012–2020, despite an increase of about 71% in the number of those obliged to report and despite the need to handle hundreds of thousands of tax refund reports. It was also found that as of 2020, 825,000 (about 70%) of the reports required to be submitted to the Tax Authority are from self-employed, constituting 6% of the total collection of direct and indirect taxes in the said year.



Expanding the Reporting Network Among Tax Evaders – the Authority collected taxes at NIS 4.94 billion following campaigns to expand the reporting network in 2014–2021.




Dealing with Severe Crimes and Fictitious Tax Invoices – value-added tax is the main component in collecting indirect taxes. Its total net collection (minus VAT refunds) in 2018–2019 was about NIS 199 billion. The total return of the VAT offices for the assessment work was about NIS 9.24 billion. In these years, the assessment charges, at NIS 4.76 billion, from the handling results of severe crime cases comprised of the distribution of fictitious tax invoices and the use thereof.

Key Recommendations

-  To fundamentally change the current situation, where tax laws are becoming increasingly complicated over the years, it is recommended to consider changing the formulation of the tax rules and base them on short, unambiguous, and easy-to-implement principles reducing the need to publish supplementary administrative instructions.
-  It is recommended that the Authority complete the "Digitization Declaration of Capital" project and implement it. It is also recommended to expand the assessment corrections

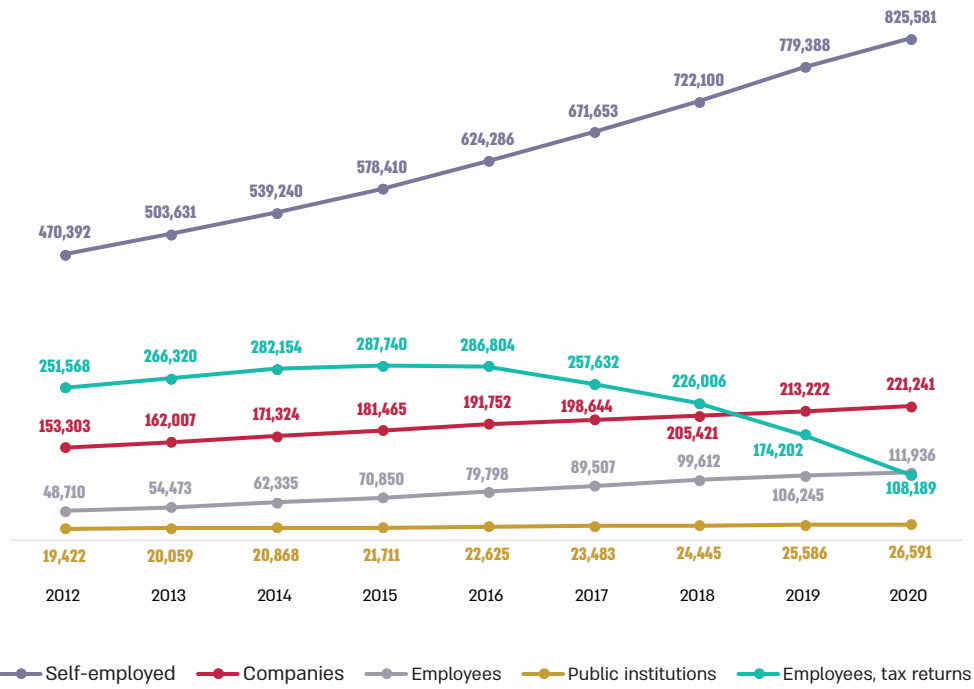


model based on technological tools. In addition, it is recommended that the Authority initiate strategic work to examine the benefits inherent in consolidating the collection activity: streamlining the system and unifying the treatment, as well as saving on bureaucracy and the administrative burden imposed on taxpayers.

-  It is recommended that the Courts Administration consider to concentrate efforts and prioritize 26 tax cases in which the disputed tax exceeded is NIS 100 million and the cumulative tax pending in the courts is about NIS 24.4 billion.
-  It is recommended that the Authority carry out strategic work and prepare a multi-year plan to implement the government's resolution goals concerning the consolidation of the tax departments, to improve its operation and the service to the taxpayer, and raise the level of tax collection.
-  It is recommended that the Tax Authority examine the supervisory resources at its disposal and their effectiveness for tax collection in Israel relative to the increase in the various sectors reports. It is further recommended to examine the extent and simplification of the different sectors reports, such as the self-employed whose contribution to the total tax collection is low, and how to simplify these reports.



Trends in the Requirement to Submit Reports According to Different Case Types in 2012–2020



Source: The Tax Authority.



Summary

The efficacy and effectiveness of the tax system are determined by its objectives: a collection of true tax, proper enforcement; promoting public service and reducing bureaucracy; preventing tax discrimination; promoting social policy goals, and more. Deficiencies in the tax system directly affect the public.

The State Comptroller's Office examined the tax system effectiveness in Israel, including its complexity and its performance measurement, its operations efficacy, its administrative and legal procedures handling tax cases and the operational aspects at the Tax Authority. The said examination raised deficiencies, affecting the activities of the Tax Authority and its effectiveness regarding the taxpayer.

Tax laws in Israel are complex and include numerous legal provisions, regulations, and precedents. This highlights the need to base the tax rules on short, unambiguous, and easy-to-implement principles to minimize the need for supplementary administrative instructions. It is also necessary to consolidate the tax departments beyond the headquarters level; promote digitization processes, by creating a computerized audit file and abbreviated assessments for relatively small businesses; shorten tax assessments appeal procedures; and promote equitable enforcement between taxpayers.

The Ministry of Finance and the Tax Authority should rectify the audit's noted deficiencies and examine its recommendations to improve the effectiveness of the tax system in Israel.



Report of the State Comptroller of Israel |
November 2022

Israel Tax Authority

The Activity of the Computerized Processing Service Unit at the Tax Authority



The Activity of the Computerized Processing Service Unit at the Tax Authority

Background

The Computerized Processing Service (SHAAM) serves as the internal computerization system of the Israel Tax Authority (the Tax Authority or the Authority), providing it with computer services for collection and enforcement for a proper deterrent and to exhaust the taxpayer's rights. SHAAM serves about 1.3 million "customers": companies, other corporations, self-employed, controlling owners, employees, and recipients of work grants, employees who perform tax adjustments and tax refunds, the 6,000 employees of the Tax Authority, 13,000 representative offices, and 7,000 lawyers. SHAAM manages hundreds of projects every year, ranging from projects for immediate implementation to projects that take several years to complete. Every year the Tax Authority establishes a work plan, including, among other things, projects for the maintenance of the existing system, for changes therein, for their development and improvement, and the establishment of new systems. The contribution of the computerized systems is essential for streamlining the Tax Authority's work, shortening the processes, increasing the reliability of the operations, documentation, monitoring, and ongoing control of the processes and decisions.



Key Figures

NIS 333
million

SHAAM's budget for 2021

221

new and ongoing projects in 2021 managed by SHAAM

119

improvement projects and changes in the existing systems in 2021 managed by SHAAM

55%

the rate of projects with deviations of over 100% in the working days allocated to the project¹

583

employees at SHAAM as of January 2022

56%

the rate of state employees among total employees at SHAAM as of January 2022


120,000

the average number of inquiries received at the SHAAM help desk² in 2019–2021

66%

the percentage of forms that are not online out of all the forms in the Tax Authority website

Audit Actions

 From November 2021 to February 2022, the State Comptroller's Office examined the activities of the Tax Authority's information systems – SHAAM. The audit included organizational aspects, the service to SHAAM customers, and the handling of system malfunctions. In addition, the project management in SHAAM, and the monitoring and control of their execution, were examined. The audit also included an examination of key business processes at the Tax Authority and their mechanization manner.

¹ Of the projects in which the rate of difference between the estimated number of days for the project and the number of days for the project updated in the system was higher than 20%.

² A unit responsible for the interface between SHAAM and its customers.



Key Findings



SHAAM's Strategic Plan – no documents were found by the audit indicating that SHAAM's management discussed alternatives to the strategic plan or its principles. In addition, the audit team interviewed SHAAM senior managers, who all stated they had no part in formulating SHAAM's strategic plan.



Planning the Work Plans, Project Management, and Their Control

- **Prioritization of the Projects** – SHAAM did not perform the processes required for making informed decisions based on updated data and prioritized the projects according to the methodology procedure, including determining estimates and examining the cost-benefit ratio.
- **Base Plan** – in contravention to the methodology procedure and the directive of the Governmental ICT Authority, all 16 non-strategic projects sampled by the audit team and 6 strategic projects have no basic plan, including a definition of actions, schedules, resources, and costs. In the absence of baseline plan data, including estimated completion dates and estimated personnel resources, it is impossible to monitor and control as required by the guidelines of the Governmental ICT Authority and the methodology procedure. Moreover, the organization's management cannot obtain an updated situation report of the project's progress, changes, and impact on the original plan.
- **Entering the Project Data into the Lapid System** – in preparation for the 2020 work plan, SHAAM began to work on the "Lapid" System, in which the project data is fed for management, monitoring, and control.
 - The system has no structured process for non-strategic projects collating all the sub-projects into a super-project. It is impossible to monitor and control the progress and deviations of the project from the set schedules and their overall cost.
 - The project's completion dates and workdays are updated in the Lapid System according to the tasks entered by the project managers and the changes therein. There is no way to verify the project plan is complete and that all the completing tasks have been entered. Moreover, it is impossible to present the projects schedules plan versus execution by Lapid System.
 - There is no report on the actual number of days the employees work; the completion rate is calculated based on the assessment of the task completion rate done by the project managers. The cost of the workforce invested in the various projects according to the type of position and employment is not



calculated, there is no link to the budget, including the costs of external consultants, and there is no data on the procurement of relevant infrastructure.

- **Deviations in the Projects** – in 32% of the new and current projects in 2021, substantial deviations were found (over 20%) between the estimated project workdays for the prioritization meetings and the project days updated in the system, indicating insufficient initial planning before estimating the number of days required for the projects. Furthermore, deviations were found in the content of 34 of the 221 projects in 2021. In 17 of them, the content status was "as planned," though by the work plan manager, there were deviations in the content.
- **Controls on Project Management** – SHAAM and the Tax Authority do not conduct controls analyzing the implementation of the annual work plan at the end of the year, and no conclusions are drawn. Moreover, there is no annual data for each year, only partial data updated by the project managers.

SHAAM's Support of Business Processes and Mechanization of Manual Processes

- **Data Mining** – to determine tax assessment, the Authority's employees must examine a significant volume of revenues and taxpayers' information. Among other things, the taxpayer's reports, tax withheld information about his employees and salary payments, intelligence information, and more. Although the information exists in the Authority's databases, the tax inspectors access some information through individual queries without an automatic process of computerized information collection and comparison. Moreover, there is no data mining process for processing the thousands of financial and accounting data found in the various information sources regarding the same taxpayer.
- **Declaration of Capital** – a capital declaration is an essential tool the income tax assessor uses when checking the taxpayer's reports. The Tax Authority employees carry out a process of capital comparison, which is a comparative examination of declarations of capital submitted over several years. The mechanization of the capital declarations will automatically enable the comparison of the capital, thus saving the Authority's employee work hours. In addition, it will enable capital comparisons of all taxpayers required to submit capital declarations and select an individual examination of taxpayers of whom the automatic examination identified unexplained capital differences. The audit found that the Tax Authority carried out the capital comparisons manually. Furthermore, the Authority did not promote the project after its characterization by a dedicated committee in 2013. At the audit completion, the online capital declarations project do not appear in the computerized system to manage SHAAM work plans (the Lapid System).
- **Withholding Tax** – withholding tax is the tax offset from revenues. The payer deducts the tax and transfers it directly to income tax. The taxpayer from whom



the tax was deducted reports the tax deducted. The total differences in absolute value between the deductions reported by those deducting and those reported by individual taxpayers was 8.65 billion in 2017 and 3.64 billion in 2018 (a decrease of 58%). In taxpayers who are companies, the total differences in absolute value were 3.02 billion in 2017 and 1.89 billion in 2018 (a decrease of 37%). The total cumulative difference (in absolute value) in 2017–2019 was about 18.6 billion. The Authority's new computerized system enables structured control to identify the differences. Still, its use is impossible for all tax inspectors and unit coordinators. The normal work process at the Authority is a manual inspection by the tax inspectors of only some files entered into the work plan and processed for assessment.

- **Computerization of the Authority's Forms** – the Tax Authority has a database that includes 322 forms in all tax systems: income tax, VAT, real estate taxation, import and customs taxes, other indirect taxes, and labor and Covid-19 grants. 111 of them are online forms. Given the rate of 63% of the customs and the import taxes forms that were computerized (out of all the customs and import taxes forms), the insignificant low rate (24%) of the computerized income tax forms (out of all the income tax forms) stands out. In addition, the rate of the customs and import taxes forms that were computerized out of all the Authority's computerized forms is 45%. In comparison, the rate of computerized income tax forms (out of all the Authority's computerized forms) is lower (35%), despite the core of the Authority's activity being income tax collection.

Organizational Aspects of SHAAM's Activity

- **Employee Sanctions** – given the disagreement between the employees at SHAAM and the management regarding the employment of outsourced workers and the use of external consultants, the workers' committee initiated sanctions. By SHAAM management documents, these actions included non-cooperation with the incubator³ and preventing the allocation of users in SHAAM systems to new, not permanent, employees in the headcount. Moreover, the workers' committee actions delayed projects included in SHAAM's work plan.
- **Shortage in Personnel** – at the audit completion, 40 civil servants positions, about 11% of the 367 existing positions, are not permanently staffed. Furthermore, 19 student positions, about 32% of the 60 current positions, are not staffed. The shortage has worsened over the years due to computer programmers' departure and the failure to replace them. The total number of permanent positions not staffed is 59, about 10% of the 606 SHAAM employees of all types of employment.

³ A development body at SHAAM where people with knowledge of new technologies work; The body operates using an agile development method.



Customer Service

- **Scattering of the Service Between Several Entities** – the strategic plan deals with a customer's response provision at one location. By the audit date, the support for representatives is divided between 3 entities (the Help Desk, the Customer Service Center, and the Representative Registration Department) providing representatives with different services. As a result, some representatives mistakenly contact the Tax Authority's Customer Service Center, which is not the entity suitable for the provision of the service.
- **The Help Desk** – the Help Desk supports thousands of customers a month and responds to inquiries that require significant knowledge. The rate of phone inquiries is 82%–87%, and the rest are through the portal. In 2019–2021, about 24,000 inquiries were received from representatives due to login difficulties, about 5,800 due to customers' computer operation problems, and about 10,000 inquiries for technical support. The department does not have a knowledge management system that enables the supporter to locate the relevant information at the click of a button. The administrative reports of the Help Desk do not include reports on days of peak inquiries or periodic characteristics of inquiries, such as peak reports of login difficulties in preparation for the reporting dates under the law – the 15th of the month, the reporting dates of the annual reports as well as when a new application goes live. In 2019, 2020, and 2021, 72%, 73%, and 75% of inquiries at the Center were closed without being forwarded to external parties. The parties to whom inquiries from the Help Desk are forwarded do not ensure the closing of the inquiry in the system after completing the handling. The Help Desk lacks handling completion information in about a quarter of the inquiries made.








The State Comptroller's Office commends the Authority's actions to significantly shorten the waiting times for SHAAM Help Desk inquiries and recommends that the Help Desk continue improving the service.

The State Comptroller's Office commends the Authority's database establishment, a prerequisite for data mining, and recommends the Authority promote the accessibility and comparison of additional information automatically and complete the rapid advancement of the data mining process.

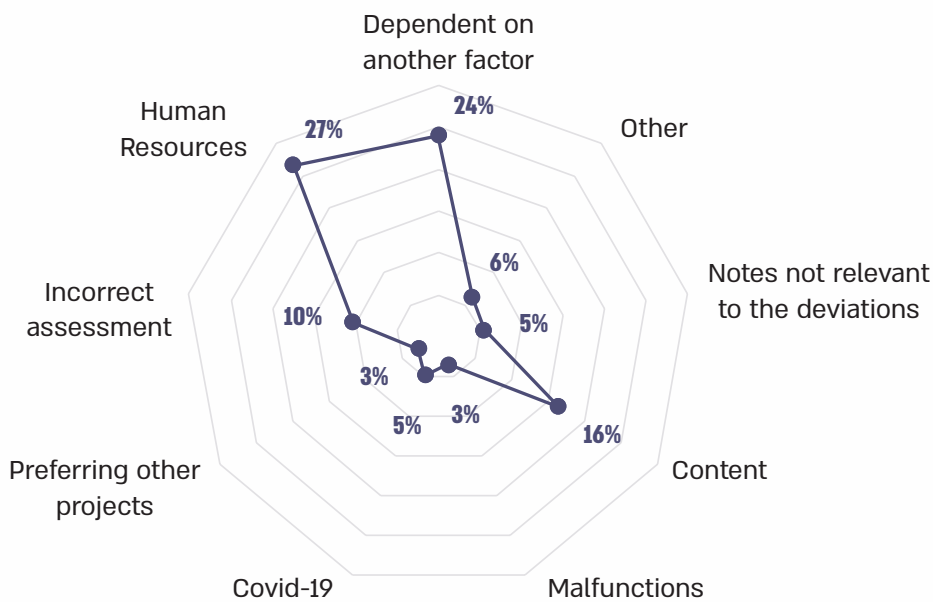
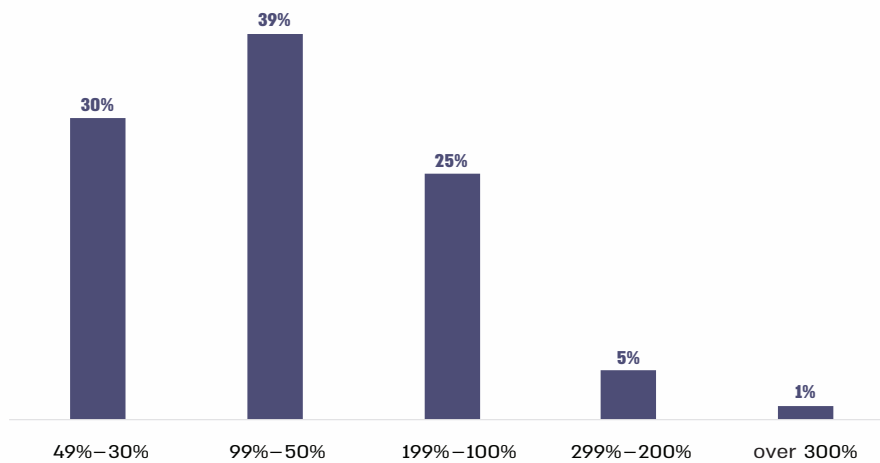


Key Recommendations

-  SHAAM should prepare basic plans for all projects upon their beginning, according to the methodology procedure and the instruction of the Government ICT Authority.
-  It is recommended that when converting to a project, SHAAM will feed the tasks for the execution of the entire project, except for unexpected changes. It is also recommended to monitor the actual execution beginning dates vis-a-vis the basic plan dates. Furthermore, it is recommended to ensure that the system execution rate corresponds to all the required tasks, including those added.
-  SHAAM should feed the tasks for the execution of the entire project in the Lapid System, including all the project costs, actual workdays, and external consultants' costs. In addition, SHAAM should include the pricing of costs affected by the positions of the personnel associated with the projects and the type of employment. At the project demand converting stage, all the tasks required for its execution will be fed into the Lapid System. A total estimate of the days required until the end of the project will be determined for project cost information and monitoring of their execution. It is further recommended that the Tax Authority and SHAAM conduct an annual audit of the latest data of all projects for a yearly analysis of SHAAM's compliance with the work plans and draw conclusions.
-  The Authority is recommended to develop a platform to receive reports into its computerized systems for retrieving reports and performing analyses and cross-checking of the information to improve the assessment processes. It is also recommended that the Tax Authority mechanize the capital comparisons, enabling automatic comparison and thus saving the working time of the Authority's employees. Furthermore, it will enable the capital comparisons of all taxpayers required to submit capital declarations and select taxpayers whose declarations have an unexplained capital difference from the outset.
-  It is recommended that the Authority centralize the response to the representatives under one roof to optimize the service. It is further recommended that SHAAM maintain regular contact with the Liaison Committee of the Institute of Certified Public Accountants to complete the handling of the issues raised by it.



Distribution of Projects in 2021 in Which the Rate of Deviations Between Estimated Project Days and Updated Working Days in the Lapid System Exceeds 20% and the Distribution of the Reasons for These Deviations⁴



⁴ According to the notes of the work plan manager.



Summary

By the report findings, SHAAM is having difficulty meeting the development requirements of the Tax Authority and with its optimal preparation for an emergency. The acceleration in technology development is expected to increase the Tax Authority's need for additional developments. In the absence of a solution to reduce the gap between the Tax Authority's computing needs and SHAAM's development capabilities, the collection and enforcement capabilities, the creation of deterrence, and the exhaustion of the taxpayers' rights at the Tax Authority will be adversely affected.

It is recommended that the Tax Authority rectify the deficiencies noted in this report and consider promoting computerization and improving the service to taxpayers, their representatives, and the Authority's employees.



Report of the State Comptroller of Israel |
November 2022

The Natural Gas Authority

The Natural Gas Distribution Network



The Natural Gas Distribution Network

Background

At the beginning of the 2000s, several natural gas reservoirs were discovered along the coast of Israel, and natural gas became the primary fuel in Israel, mainly for local electricity production and industry. As of 2021, the annual natural gas consumption is about 12 BCM¹. Natural gas saves costs compared to oil prices, reduces dependence on imported oil, and significantly benefits the environment compared to the petroleum distillates that were widely used until the introduction of the gas.

The natural gas from the reservoirs in the Mediterranean Sea reaches the consumers through two gas systems – the transmission system under the responsibility of Israel Natural Gas Lines Ltd. (INGL) and the distribution network developed by private concessionaires who won the Gas Authority tender.

In 2016, the State Comptroller's Office published an audit report on the connection of consumers to the natural gas distribution network (the previous audit)². This report, among other things, is a follow-up on rectifying the main deficiencies noted in the previous audit.

1 BCM - Billion cubic meters.

2 State Comptroller, **Report 67A** (2016), "Connecting Consumers to the Natural Gas Distribution Network", p. 903.



Key Figures

22%

the consumers' rate of natural gas in the distribution network in 2021 (102 consumers, whose total annual consumption was 0.3 BCM) from the target set by the government in 2020 (450 consumers)

**NIS
0.8–1.9
billion**

the loss of the cumulative saving to the economy in 2020–2025 due to the backlog in consumers connection, the lowering of the target, and the postponement of the target year by five years

**about
50%**

the rate the Natural Gas Authority reduced from the target set in a government resolution in 2015 regarding the number of consumers who are expected to be connected and consume natural gas by the distribution network in 2020

**NIS 217
million**

direct and indirect support (through the transmission system tariffs), not according to the distribution license tenders principles, that the distribution companies will bear the total costs of the distribution network

**4 residential
neighborhoods
and only one
town**

were connected to the distribution network in Israel (in the Negev region) as of March 2022. The town, previously connected by pipeline to an onshore gas reservoir, was converted to the regional distribution network. In addition, as part of a joint experiment by the Israel Lands Authority and the Natural Gas Authority to connect 18 residential neighborhoods, they began to lay the distribution network in three of these 18 neighborhoods

**about
55%**

of the factories (82 out of 149) that received connection and conversion grants from the Authority for Investments and the Development of Industry and the Ministry of Economy at the Ministry of Economy were not connected to the distribution network

**about
4%**


of the 471 megawatts allocated in the 2018 regulation of the Electricity Authority are generated at the audit end by natural gas power generation facilities in the electricity distribution network

**170
vehicles
only**

powered by compressed natural gas were found in Israel in 2020 (about 0.05% of all heavy vehicles in that year), despite the government's plans to switch to natural gas




Audit Actions


 From June 2021 to March 2022 (the audit period), the State Comptroller's Office examined the status of the distribution network layout by the audit end, including the distribution network development policy, the government assistance to the distribution companies and end consumers, the bureaucratic barriers to the development of the distribution network and its economic model. The audit was conducted at the Ministry of Energy and Infrastructures, the Natural Gas Authority, the Ministry of Finance, the Electricity Authority (Electricity), the Ministry of Economy and Industry, the Ministry of Environmental Protection, the Ministry of Transport and Road Safety, the Israel Electric Company Ltd., and the Noga – Israel Independent System Operator Ltd. company.

Completion examinations were conducted at the Ministry of Health, Clalit Health Services, the Israel Standards Institute, the Israel Natural Gas Lines Ltd., and the Fire and Rescue Authority. Data was also received, and the attitude of the distribution companies that are private concessionaires (operating as companies in the infrastructure sector, which won the tenders published by the Gas Authority to establish the distribution network), was examined. It should be noted that although these companies are obligated to form the distribution network, they are private companies, not audited entities, and therefore the applicability of the audit does not apply to their work.

Key Findings




 **Failure to meet Targets Regarding Connecting Consumers to the Distribution Network** – 13 years after granting the first distribution licenses, the rate of consumers of natural gas in the distribution network is only about 22% of the set target (102 out of 450 consumers). The failure to meet the target and the postponement of the deadline for connecting half of the number of consumers set in the government's decision constitutes a loss of savings to the economy at NIS 0.8–1.9 billion³.


 **Procedure for Lowering the Targets for Connecting Consumers** – in November 2020, the Natural Gas Authority lowered the target of the number of natural gas consumers from the distribution network by about 50% (225 consumers) compared to the target set for 2020 (450 consumers), in Government Resolution 352 in 2015. The resolution also postponed the connection of these consumers by five years, to 2025,


3 See the calculation in the chapter "Development in the layout of the distribution network in the years 2016 - 2021".




both without an orderly discussion or approval of the change of targets in government resolutions.





-  **Government Funding of the Distribution Network** – until the audit end, the state invested NIS 537 million in the distribution network project. 40% (NIS 217 million) – not according to the distribution license tenders principles by which the distribution companies will bear the total costs of the distribution network, 23% (NIS 124 million) – according to the distribution license tenders principles, 25% (NIS 136 million) – support for connecting remote consumers and specific consumers, and 11% (NIS 60 million) – in conversion grants for end consumers.

-  **Information on the Distribution Companies Investments** – by the audit end, the Natural Gas Authority has no updated information regarding the scope of investment of the distribution companies, nor on the scope of investment of the distribution companies net of the support grants transferred by the state and net of the budgets diverted from the INGL. Moreover, even though the Natural Gas Sector Law authorized the Natural Gas Authority to demand information essential for supervising the implementation of the provisions of the law and the licenses, the Authority made do with the distribution companies' information at the times they believed they had met the milestones.

-  **Connecting Factories that Received Connection and Conversion Grants to the Distribution Network** – 82 factories out of 149 received grants from the Authority for Investments and the Development of Industry and the Economy at the Ministry of Economy (about 55% of all factories that received connection and conversion grants) were not connected to the distribution network. The Investment Authority examined the effectiveness of the grants track in July 2017, and since then, no such examination has been carried out. However, the Natural Gas Authority reviewed the financing of the conversion costs to natural gas in August 2021, and the Investment Authority and the Natural Gas Authority adjusted the CEO's Directive and changed it several times, according to the 2017 grant track effectiveness and the financing of the conversion costs reviews from 2021. It should be noted that the deficiency was raised in the previous report and was not rectified.

-  **Development Barriers Arising from the Distribution Licenses Economic Model** – even though the distribution licenses were first granted five years after the transmission license and the distribution and transmission licenses are granted for 25–30 years, the distribution network developed at a slow pace compared to the goals set by the government and to the development of the transmission system. The economic model of the distribution network, and particularly the rigidity in updating the distribution rates, the absence of anchor consumers, and the ability to charge for use only, compared to the transmission system economic model, may reduce the economic viability of expanding the network's deployment. It should be noted that the fundamental principles of this model were set in the distribution tenders and were known to those who took part therein.



-  **The Changes Effects on the Electricity Authority's Regulation** – in November 2019, the Electricity Authority published the list of the 166 electricity producers who won the competitive procedure for establishing electricity production facilities and the capacity allocated to them – 471 megawatts. In 2018–2021, ten winners established electricity production facilities with a total volume of about 20 megawatts (4.2% of the 471 megawatts allocated). At the audit completion, not one of the facilities established was integrated into the electricity network. The current regulation may harm the distribution network consumers who intend to develop electricity production facilities and the natural gas distribution network in general. According to some distribution companies, establishing these facilities may harm their profitability if the Electricity Authority updates the demand hour clusters.
-  **Conversion of the Heavy Transportation Sector to Natural Gas Use** – despite the goals set in the government's decisions and the various programs, as of 2020, about 170 vehicles powered by CNG (compressed natural gas) traveled in Israel including about 130 were buses, 15 garbage trucks and a small number of heavy vehicles of various types – about 0.05% of 340,000 heavy vehicles that travel in Israel as of 2019, and about 1.5% of the projection estimated by the Ministry of Energy for 2030 (11,600 vehicles powered by the CNG). Moreover, by the audit completion, eight CNG refueling stations were established – six mobile CNG refueling stations and two CNG refueling stations connected to the transmission system. Government Resolution 3080 charged the Ministry of Energy and the Natural Gas Authority to increase and expand the demand for natural gas in the distribution network through other potential sectors. Additionally, a series of government resolutions over the previous decade decided to convert the heavy transportation sector to natural gas – a new sector expected to generate considerable demand for natural gas in the distribution network. However, the Ministry of Energy and the Natural Gas Authority could not harness the Ministry of Environmental Protection and Ministry of Transportation to convert the heavy transportation sector to use natural gas on a significant scale.
-  **Converting the Domestic Sector to Natural Gas** – as of the audit completion, four residential neighborhoods in Israel were connected to the natural gas distribution network, and a town previously connected by pipeline to an onshore gas reservoir – all in the Negev region. In November 2019 they began to install the distribution network in three of the 18 neighborhoods defined in the pilot. In recent years, the Ministry of Energy and the Natural Gas Authority, an auxiliary unit thereon, converted the domestic sector to natural gas without coordination. In the last four years, the Natural Gas Authority promoted the connection of the domestic sector to the natural gas distribution network, and in contrast, the Ministry of Energy carried out feasibility studies for switching to electric technology without examining the natural gas alternative.
-  **Bureaucratic Barriers to the Network Deployment** – since the licenses were given to the distribution companies, they encountered various difficulties: objections from local authorities and infrastructure companies to the deployment of the network, payment demands of infrastructure companies, failure to centralize the information required for






planning the route in a nationwide system. The bureaucratic barriers make connecting consumers to the distribution network challenging and delay its development.





Changing the Conditions for Updating and Adding New Rates – upon the audit completion, the Budget Division of the Ministry of Finance and the Natural Gas Authority changed the legislation, so the Gas Council could update the distribution rates and even add different systemic rates from time to time, and not just every five years, as was the practice until now. These changes were incorporated into the Natural Gas Sector Law, 2002, in November 2021.

Allocation of Grants to Accelerate the Deployment of the Network in Peripheral Areas – it was raised that to connect peripheral areas such as the Galilee, Haifa, Hadera and the valleys to the distribution network, the Ministry of Energy and the Natural Gas Authority allocated 33% of the grant (at NIS 29 million) from the second acceleration program in 2019 and 97% of the grant (at NIS 97 million) from the third acceleration program in 2021. The allocation of these grants is consistent with the government's plans to promote and develop peripheral areas in Israel.

Key Recommendations

-  It is recommended that the Natural Gas Authority examine the distribution network targets, update them and approve them in an orderly procedure in government resolutions.
-  It is recommended that the Ministry of Energy and the Natural Gas Authority examine whether the distribution companies are fulfilling their part in the development of the distribution network, at the pace set in the license, frequently and proactively, to identify and deal with barriers. It is further recommended that the Natural Gas Authority demand all the companies to provide data of the volumes of their investment regularly and orderly and validate the information it has about the investment volumes. Furthermore, for formulating various assistance programs.
-  It is recommended that the Electricity Authority and the Natural Gas Authority cooperate to promote the development of the electricity and the natural gas sectors, considering the effects of the regulatory changes in the electricity sector on the viability of establishing power generation facilities in the distribution network.



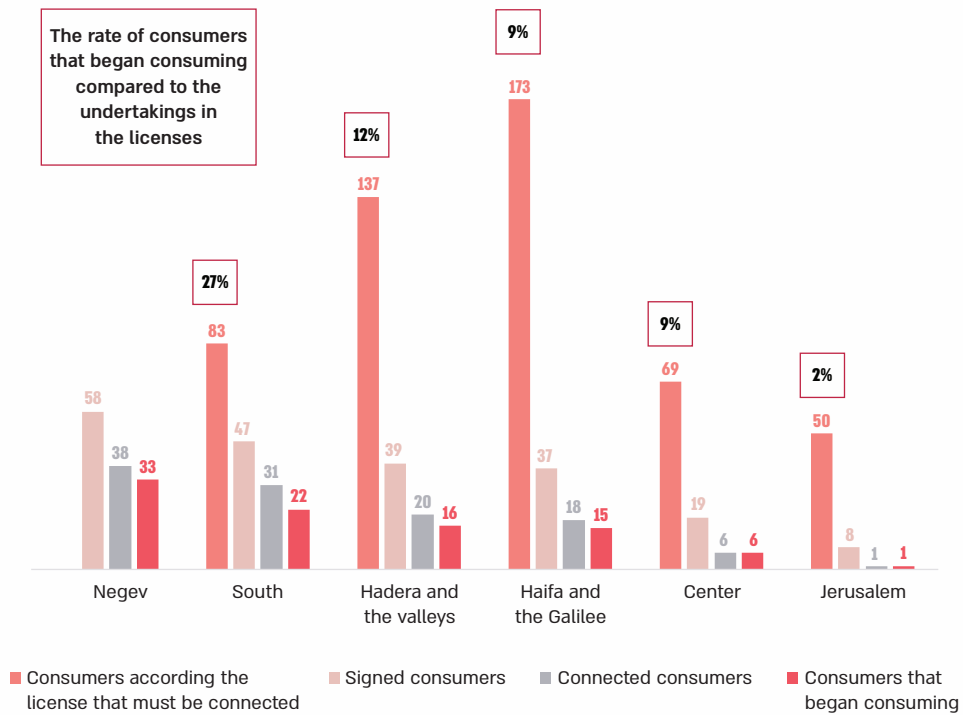
-  It is recommended that the Noga Company⁴ and the Israel Electric Company Ltd. cooperate in developing and adapting the electricity network to accommodate new electricity production facilities in the network.
-  It is recommended that the Ministry of Energy, Transportation, and Environmental Protection cooperate and formulate an agreed and appropriate short and medium-term goal plan regarding the heavy transportation sector.

⁴ A new government company responsible for managing, planning and developing the electricity system. The company works to ensure a regular supply of electricity with the reliability and quality required for all consumers in the electricity sector, in routine and emergency situations, and manages the trade in electricity under competitive and equitable conditions.



The Number of Natural Gas Consumers Compared to the Plan Set in the Distribution Licenses in each Distribution Area, December 2021⁵

The rate of consumers that began consuming compared to the undertakings in the licenses



According to the Natural Gas Authority data, processed by the State Comptroller's Office.

5 In the Negev region, a list included in the license of consumers that must be connected has not been determined, and therefore the performance ratio compared to the license is not shown. Consumers in respect of which it was determined in the license that they must be connected – consumers whom distribution companies have committed to connect to the regional distribution network. This list of consumers was added as Appendix C to the distribution licenses (see clarifications regarding this appendix in the chapter "Key findings of the distribution network by regions"); Signed consumers – consumers who have signed an agreement to connect to the distribution network with the distribution companies; Connected consumers – consumers connected to the distribution network; Consumers who have begun consuming – consumers who actually consume natural gas in the distribution network as of the completion of the audit. The chart data is based on the most recent detailed data (broken down into regions) provided by the Gas Authority. See slight updates provided by some of the distribution companies to the chart data in the chapter "Key findings of the distribution network by regions".



Summary

The transition to natural gas use as a significant energy source in Israel is a project of national importance as it has economic, political, and environmental benefits. However, over a decade after the beginning of the distribution network project, it was found that it is progressing at a slow pace compared to the set plan and projections. The demand forecasts of the Natural Gas Authority and the distribution companies at the beginning of the project, the basis of goals formulated for the network deployment later on, did not materialize regarding the consumers number connected to the distribution network and the scope of consumption. The failure to realize the demand forecasts is partly due to the continuation of the project beyond the schedules set in the licenses. In addition, the goals set by the government regarding the completion of the deployment were not realized, among other things, due to bureaucratic delays of infrastructure companies and local authorities, matters concerning the coordination of work with the distribution companies, the occurrence of technological changes in the energy sector, and ambitious goals for the transition to a low-carbon economy.

The conversion of new demand sectors, such as the heavy transport and the domestic sectors, to natural gas use, increasing the distribution network demand, was carried out slowly, as of the audit completion, only one town and four residential neighborhoods were connected to the distribution network and there is no natural gas refueling station connected to the distribution network. The slow conversion of these sectors, alongside technological changes in the mix of energy sources and the natural gas economy in particular, raise doubts about the feasibility of conversion on a significant scale. All this, while the economic model in the distribution licenses remains relatively rigid despite these changes. However, the economic model stipulated in the distribution licenses was known to the distribution companies during the tender submission stages. Moreover, the limitations of the economic model do not detract from fulfilling the conditions and obligations stipulated in the licenses. Some of the delays mentioned above were examined in the State Comptroller's Office's previous audit report, published in 2016.

By the audit in December 2021, only about 22% of the distribution network consumers used natural gas, according to the target set for 2020 in Government Decision 352. Failure to meet the set target, the rate of actual consumers, lowering the target by 50%, and postponing it for five years is expected to result in a loss of savings to the economy at NIS 0.8 to 1.9 billion.

The Ministry of Energy, in cooperation with the Ministries of Finance, Economy, and Environmental Protection, should promote natural gas use and develop the distribution network optimally, according to the government's resolutions, to save energy costs for the manufacturing industry in Israel and reduce air pollution.



Report of the State Comptroller of Israel |
November 2022

Ministry of Economy and Industry

The Government's Handling of the Increase in Online Commerce – Follow- up Audit



The Government's Handling of the Increase in Online Commerce – Follow-up Audit

Background

The digital economy has recently aroused great interest in consumer, competition, and privacy aspects. It is on the agenda of many authorities worldwide, among other things, due to the increase in the influence of internet giants, social networks, and digital platforms. From 2017 to 2020, the average annual revenue rate per user of online commerce increased by about 1% per year, and in 2021 it was about USD 1,000. In 2025, it is expected to be about USD 1,174. The online commerce average annual revenue per user in Israel is expected to increase from about USD 1,101 in 2017 to about USD 2,311 in 2025. The use rate of online purchases, about 28% in 2017, rose to about 45% in 2020. In 2022, the exemption from VAT on personal importing was repealed in the European Union countries and Australia. The USA's exemption from VAT and customs duties stands at USD 800. In Israel, a shipment containing goods with a total value of up to USD 75 is entirely exempt from import taxes, and for higher amounts, taxation is gradual.

The digital economy has important implications given the significant changes in the worlds of commerce and consumption, in digital services, search engines, social networks, cloud services, and more, and given the collection of information on consumption habits and consumer preferences. These pose considerable national and global challenges, requiring a reexamination of the existing regulation and the development and integration of advanced tools for analysis and enforcement.

In 2018, the State Comptroller's Office published a report on The Government's Handling of the Increase in Online Commerce (the Previous Audit)¹. The report noted deficiencies in the government's handling of this issue, including the following: the authorities have not yet regulated changes concerning personal importing, the legality of importing, the Personal Importing Order has not been amended to facilitate this type of import; the Privacy Protection Authority in the Ministry of Justice did not have a technological solution for automatic retrieval of data on the sections of the law for which violations were determined in the enforcement files and on the scope of the use it makes of its authority to impose a financial fine on the violators, and the Ministry of Education did not teach financial education and smart consumerism programs in primary and secondary schools.

This report follows up on the rectification of the deficiencies noted in the previous audit.

1 The State Comptroller, Annual Report 69A (2018), "The Government's Handling of the Increase in Online Commerce", p. 209.



Key Figures

USD 5 billion

online commerce revenues in Israel in 2020

USD 12 billion

online commerce revenues forecast in Israel in 2025

53%

the percentage of businesses in Israel that recorded a moderate increase (up to 25%) in the scope of online trading activity following the Covid-19 pandemic

59%

the percentage of consumers who suffered injustices² in online transactions in the food sector among the buyers in the sector (according to the State Comptroller's Office survey)

35%

the average percentage of consumers who suffered injustices among buyers in all sectors (according to the State Comptroller's Office survey)

107

the number of administrative enforcement procedures carried out by the Privacy Protection Authority in 2020 against violators of the provisions of the law


50%

the percentage of 16–18 year-old persons who shop online more than once

36%

the percentage of small and medium-sized businesses whose online commerce exceeded 50% of their total turnover in 2021

Audit Actions

-  From August 2021 to December 2021, the State Comptroller's Office conducted a follow-up audit examining the actions taken by various government ministries to rectify the deficiencies noted in the previous audit and the extent that they were rectified. The follow-up audit was carried out mainly in the Legality of Import Commissioner's Unit, in the Small and Medium Business Agency (the Small Business Agency), and in the Senior Division for Professional Training and Human Capital Development in the Ministry of

² The Injustices: Prolonged waiting time; Receiving a defective product; Charging in excess of the cost of the product or service; Failure to receive the product or service; Refusal of an attempt to return a product; Difficulty disconnecting from service; Refusal to accept payment by credit card.






Economy and Industry (the Ministry of Economy). Supplementary examinations were conducted at the Ministry of Justice, at the Commission of Equal Rights for Persons with Disabilities and the Privacy Protection Authority at the Ministry of Justice (the Privacy Protection Authority), at the Pedagogical Secretariat in the Ministry of Education (the Ministry of Education), at the Israel Consumer Council, at the Authority for Economic Development of the Minority Sectors in the Ministry of Social Equality, at the Planning Administration in the Ministry of the Interior, the Competition Authority, the Foreign Trade Administration in the Ministry of Economy, the Ministry of Transportation and Road Safety (the Ministry of Transportation), the Ministry of Health, the Ministry of Communications, the Ministry of National Infrastructure, Energy and Water (the Ministry of Energy), the Ministry of Agriculture and Rural Development (the Ministry of Agriculture), at the Israel Export Institute (the Export Institute), and in the municipalities of Beer Sheva, Rishon Lezion, Kfar Saba and Ashdod. The follow-up audit was expanded to examine standard form contracts and the accessibility of online trading to the ultra-Orthodox sector. Moreover, the State Comptroller's Office conducted an online public participation survey on "Consumer Issues".

Key Findings



Findings Noted in the Current Audit

-  **The Rate of Those Reading the Use Terms and the Civil Injustices Among Online Commerce Consumers** – according to the State Comptroller's survey from December 2021, 92% of the participants make online purchases and 56% of them do not read the terms of use on the shopping site. The percentage of consumers who purchase clothing and footwear online is 58%, and 45% of them encountered injustices. In the food industry, the percentage of consumers making purchases online is 42%, and 59% of them encountered injustices.
-  **Ultra-Orthodox Sector Online Commerce** – it was raised that as of 2020, only about a quarter of the adult ultra-Orthodox population makes online purchases, compared to over half of the rest of the population; Furthermore, barriers were found in digital literacy skills in this population.
-  **Examination of Standard Form Contracts of the Online Commerce Sites by the Ministry of Justice** – it was raised that the Ministry of Justice operates by sending the Attorney General requests for opinions and submits objections to compromises in relevant class action suits. However, it does not proactively examine standard form contract-bylaws of the online commerce sites.



Scope of Enforcement Procedures by the Privacy Protection Authority – it was raised that in 2020, on the one hand, there was a 22% increase in the initiation of administrative enforcement procedure cases by the Privacy Protection Authority, from 88 cases in 2019 to 107 cases in 2020, and on the other hand, there was a 40% decrease in the completion of enforcement procedures, from 58 cases in 2019 to 35 in 2020. Furthermore, there has been an increase in initiating criminal enforcement proceedings and their completion. However, the fines levied were about NIS 135 thousand regarding approximately USD 5 billion of online trade in Israel in 2020. The Protection of Privacy Law has outdated definitions of key terms and does not address significant issues in online commerce. However, it was found that the Ministry of Justice dealt with the issue in June 2021. It promoted the Protection of Privacy Law (Amendment No. 14), and in November 2021, the Ministerial Committee for Legislation approved the bill. In January 2022, it was submitted to the Knesset and approved in a first reading. It was further found that the Ministry of Justice published a position paper on the right to information mobility.


Rectifying the Deficiencies Noted in the Previous Audit


Financial Education Programs in the Ministry of Education – the previous audit found that all the financial education programs do not address smart online consumerism. The current audit found that the **deficiency has been rectified to a limited extent**. The Shopping Habits Report (June 2019), of teenagers between the ages of 16 and 18 found that there is noticeable parental involvement in paying for online shopping, yet about a third of the youth in these ages who usually shop online, pay for the purchase themselves. The survey also indicated that financial independence is more prevalent among boys and increases with age. A link was found between the frequency of purchases and increased reporting of independent payments. According to the audit findings, 191 thousand students participated in the "Safe Surfing Week" held by the Ministry of Education in February 2022. In the "Money Week" held in March 2022, only 4,000 students participated out of about 758 thousand middle and high school students during the 2019–2020 school year. It was further raised that by the audit completion date, the Ministry of Education had formulated content for an online commerce program that was to be integrated within the framework of the Ministry's multi-age program; but has not yet approved the contents and their implementation. It was also found that privacy protection and online fraud are not addressed in the Ministry of Education's future plan for online commerce education.

Senior Citizens – according to the previous audit, informational workshops on "smart consumerism" do not emphasize smart consumerism online. The current audit found that **the deficiency has not been rectified**. From 1,128,000 senior citizens as of 2020, the total number of senior citizens who participated in the "Digital Israel Program" in 2018–2021 was approximately 8,400 in the smart consumerism sessions and approximately 5,000 in the maintaining the privacy and online safety sessions. However,



the Ministry of Social Equality and the Israel Consumer Council have not mapped the needs and barriers for the senior citizens and have not formulated a plan for online consumerism among the senior population.

 **Small Businesses in the Arab Sector** – according to the previous audit, no private or government body has data on the number of small businesses from the Arab sector conducting online sales. The Authority for Economic Development of the Minority Sectors in the Ministry of Social Equality has no such information either, and it does not carry out studies identifying the sector's online commerce difficulties and needs. By the follow-up audit, **the deficiency was rectified to a limited extent**. According to the Israel Internet Association survey in 2020, the percentage of people who did not shop online among the Arab population is 57% 11 times higher than the percentage among the Jewish population. However, the Small Business Agency and the Authority for Economic Development of the Minority Sectors did not collect information on the number of small businesses from the Arab sector selling online. The Authority does not have an online commerce plan for this sector, and the Agency operates through the MAOF branches³. Still, in the absence of information on the number of small businesses in the sector, it can not measure whether its operations are effective.

 **Collection of Data on the Local Authorities Activities in Online Commerce** – the previous audit recommended that the local authorities consider changing retail purchasing patterns and their effect on the present and planned shopping centers in terms of physical space needed. Consequently the municipalities should examine the need to formulate guidelines for planning shopping areas in master plans. These plans should include types, location, and distribution. The follow-up audit found that **the deficiency was rectified to a limited extent**. The audited local authorities (Ashdod, Kfar Saba, Beer Sheva) did not collect organized data on the activity of online commerce in the city and, therefore, could not determine the effects of the increase in this type of commerce on the number, size or the location of planned commercial centers and the expansion of existing commercial centers.



Personal Importing Order – according to the previous audit, the Ministries of Economy and Finance had not yet established a computerized system for personal importing, the relevant authorities have not completed regulatory changes relating to personal importing and the legality of importing, and Personal Importing Order, 2018 (the Personal Import Order) was not amended to issue a certificate of compliance with the import legality requirements within two working days. The follow-up audit found that **the deficiency was fully rectified**: the Personal Import Order was amended to issue a certificate of compliance with the import legality requirements within two working days,

3 Maof is a group of business information centers funded by the Department of Economy and Industry.



and a computerized system for personal importing of the Tax Authority and the Ministry of Economy was also activated.

The Legality of Importing – according to the previous audit, some of the relevant authorities have not yet adapted the importing of the products under their purview to the rules of personal importing and reduction of products for which certificates of compliance with the import legality requirements must be provided. Furthermore, some changes require adapting the relevant legislation and procedures. The follow-up audit found that **the deficiency has been fully rectified**. The relevant authorities, including the Ministries of Health, Agriculture, and Transportation, have adapted the import of the products under their purview to the rules of personal importing.

Amendment of the Protection of Privacy Law – according to the previous audit, the Protection of Privacy Law includes outdated definitions of key terms and does not address significant issues in online commerce. This audit found that **the deficiency has been rectified to a large extent**: the Ministry of Justice did not amend the law, however, it published a position paper on the right to information mobility and is working to regulate the matter.






Accessibility of Online Trading Sites for Persons with Disabilities – according to the previous audit, the Commission of Equal Rights for Persons with Disabilities did not collect information indicating the extent the amendment of the regulation contributes to the accessibility of the sites for persons with disabilities and on the rate of persons with disabilities using the internet, including online trading sites. The follow-up audit found that **the deficiency has been rectified to a large extent**. Every year, the Commission generates a statistical report on persons with disabilities in Israel. It increased enforcement and examined 486 sites; and essential and central sites were made accessible to the public. However, this did not increase the rate of persons with disabilities using them. The Commission's data indicates that the rate of persons with disabilities who used the Internet to purchase products and services remained similar in recent years and decreased slightly (37% in 2017 compared to 35% in 2019).

Key Recommendations



The Ministry of Economy and Finance, should lead the fight against the cost of living, in consultation with the Competition Authority, should consider increasing the tax exemption on personal importing as an additional tool to reduce the cost of living and even consider increasing the tax exemption for products and areas with a market failure or abuse and charge of an excessive price by monopolies or exclusive importers with significant market power.



-  The Ministry of Justice should proactively review standard form contract-bylaws online trading websites and update the Protection of Privacy Law to respond to technological and commercial developments, the growth of online trading, and the protection of consumer privacy consequences.
-  The Privacy Protection Authority should examine the congruency between the scope of enforcement carried out by it with the scope of online trade. It is recommended to formulate a proactive enforcement plan and encourage the public to contact the Authority in any case information provided by them has been used for other than the purpose for which it was provided.
-  The Ministry of Social Equality and the Israel Consumer Council should map the needs and barriers of the senior citizens and formulate a dedicated program for them on consumerism online.
-  It is recommended that the Ministry of Economy and the Authority for Economic and Social Development of the Ultra-Orthodox Sector form online commerce content accessible to the ultra-Orthodox public, considering their needs. An increase in internet use in this sector can increase productivity and revenue in the economy.
-  It is recommended that the Small Business Agency and the Authority for Economic Development of the Minority Sectors cooperate in obtaining data on the participation of the Arab sector in online commerce and prepare targeted programs for this population to close the gaps in online purchases between them and the general public. It is further recommended that the Small Business Agency implement the relevant parts of Government Resolution 550: to continue the Agency's activities in Arab society; To develop unique consulting tracks for the Arab sector, grants, and success-based incentives that will promote the capabilities of small and medium-sized businesses in Arab society.



The Extent of Rectification of the Key Deficiencies Noted in the Previous Report

The Audit Chapter	The Audited Body	The Deficiency/ Recommendation in the Previous Audit Report	The Extent of Rectification of the Deficiency Noted in the Follow-up Audit			
			Not Rectified	Slightly Rectified	Considerably Rectified	Completely Rectified
Exemption from tax on personal imports	Ministry of Finance and Ministry of Economy	The Ministry of Finance and the Ministry of Economy should examine whether the steps they are taking are sufficient to reduce the harm to the retail sector.				
Customs calculator for personal importing, amendment of the Personal Importing Order	Ministry of Finance and Ministry of Economy	The Ministries of Economy and Finance have not yet established the computerized system for personal importing, the relevant authorities have not yet completed the amendments to the regulations of personal importing and the legality of the importing, and the Personal Importing Order has not been amended to issue a certificate of compliance with the import legality requirements within two working days.				
Protection of consumer privacy on online trading sites	Ministry of Justice	The existing legislation in the Protection of Privacy Law includes outdated definitions of key terms and does not address important issues in online commerce.				



The Audit Chapter	The Audited Body	The Deficiency/ Recommendation in the Previous Audit Report	The Extent of Rectification of the Deficiency Noted in the Follow-up Audit			
			Not Rectified	Slightly Rectified	Considerably Rectified	Completely Rectified
Enforcement actions of the Privacy Protection Authority	Privacy Protection Authority	The Privacy Protection Authority did not provide the State Comptroller's Office with information on the extent of violations of the Protection of Privacy Law that were presented to it regarding the collection of online information and on the extent of its use of its authority to impose financial fines on the violators.				
Individual recommendations regarding the barriers in the relevant authorities	The authorized authorities	Some of the authorized authorities have not yet adapted the import of the products under their purview to the rules of personal importing, nor have they reduced the number of products for which certificates of compliance with the import legality requirements must be provided, and some of the changes require adjustments to the relevant legislation and procedures.				
The amendment to the Accessibility Regulations	Commission of Equal Rights for Persons with Disabilities	The Commission did not collect information on the extent the amendment to the regulations contributes to the accessibility of websites for persons with disabilities, and information on the rate of persons with disabilities who use the internet, including online trading sites, out of all persons with disabilities.				



The Audit Chapter	The Audited Body	The Deficiency/ Recommendation in the Previous Audit Report	The Extent of Rectification of the Deficiency Noted in the Follow-up Audit			
			Not Rectified	Slightly Rectified	Considerably Rectified	Completely Rectified
Education and information on online consumerism	Ministry of Education	The Ministry of Education should promote the integration of education for smart consumerism on the internet, on all its characteristics, in other existing programs.				
Education and information for senior citizens	Ministry of Social Equality and the Israel Consumer Council	The Ministry of Social Equality and the Consumer Council should cooperate and pool resources to map the needs and barriers of senior citizens and formulate a dedicated program on internet consumerism. It is recommended that the Council emphasize the subject of online commerce in its workshops and provide assistance on the subject.				
Cooperation between the Small Business Agency and the Export Institute	Small Business Agency and the Export Institute	The Small Business Agency and the Export Institute should examine together whether to cooperate or at least share knowledge on online commerce courses.				
	The Export Institute	The Export Institute should examine over time not only the satisfaction of the participants in its courses but also the effectiveness of the courses to help the participants integrate into online commerce.				



Summary

Recently, the online retail market in Israel has grown at an annual rate of about 33%, and it is estimated that in 2025 it will reach USD 12 billion. Online commerce – personal importing from abroad and purchases from local suppliers – allows consumers access to new markets and an almost unlimited variety of goods at different prices. In the Israeli economy, characterized by excessive supra-sectoral concentration compared to other markets, personal importing is a channel for increasing competition and reducing the cost of living. At the same time, the increase in online commerce poses national and global challenges that require constant examination of the regulation to bring about the prosperity of the entire economy.

The follow-up audit found that some of the deficiencies noted in the previous audit were rectified. The government ministries and the relevant bodies should completely rectify the deficiencies and implement the recommendations noted in the previous audit. Given the price increases in the economy and the increase in the cost of living in Israel, it is recommended that the Ministry of Economy and the Ministry of Finance, who are leading the fight against the cost of living, in consultation with the Competition Authority, consider expanding the tax exemptions on personal importing as an additional tool in the fight while balancing the need to protect certain parts of the retail sector. It is also recommended to consider increasing the tax exemption for products and areas with market failure or abuse and excessive price collection by monopolies or exclusive importers with significant market power.



Report of the State Comptroller of Israel |
November 2022

Ministry of Economy and Industry

Consumer Protection Issues



Consumer Protection Issues

Background

The consumer public in Israel, especially consumers from among populations deserving support, such as new immigrants, the elderly, and minors, are in many cases at a disadvantage vis-à-vis business owners. Consequently, laws were enacted to ensure the rights of consumers, and a government regulation system was established to implement the provisions of the laws on consumer issues and to enforce them.

Consumer legislation in Israel includes several laws, the principal one is the Consumer Protection Law, 1981 (Consumer Protection Law). The law imposes duties on business owners, the main of which are disclosure, marking of goods, and displaying product prices. Moreover, it forbids misleading the consumer and taking advantage of their adversities.

The Minister of Economy and Industry (the Minister of Economy) is in charge of consumer protection and is responsible for implementing the provisions of the Consumer Protection Law and the Israel Consumer Council Law, 2008 (the Council Law).

Government bodies have been established under laws to monitor and enforce consumer protection laws and protect consumer's rights. The Consumer Protection and Fair-Trade Authority (the Consumer Protection Authority) is an independent entity established under Amendment 20 to the Consumer Protection Law in 2006. Among other things, it enforces the provisions of consumer legislation, foremost the Consumer Protection Law. The Israel Consumer Council (Consumer Council) a government company, is a consumer organization under the Council Law, and among other things, protects consumers and preserves their rights.

In addition, the Minister of Finance, the Minister of Justice, the Bank of Israel, and several government ministries, including the Ministry of Economy and Industry, the Ministry of Communications, and the Ministry of Energy, have the authority and means to guarantee consumer rights.



Key Figures

514 enforcement cases

opened by the Consumer Protection Authority in 2021 – a reduction of 50% compared to 2018. Of these, three criminal cases were opened

only 31%

the collection rate for the sanctions imposed on businesses by the Consumer Protection Authority in 2018–2021 (NIS 37 million were collected out of NIS 119 million imposed)

15 class actions

filed by the Israeli Consumer Council in 2019–2021 out of 1,603 total class action lawsuits filed on consumer issues in those years (about 1% only)

over 76% of the public

suffered a consumer injustice in 2020–2021 (according to the State Comptroller's Office public participation survey)

2.9 out of 5

the satisfaction level with the Israeli Consumer Council of those who inquire about it. By the State Comptroller's Office public survey, 40% were satisfied with the Council's handling of their inquiries – a low level of satisfaction

about NIS 16.6 million

estimate of the voucher value that consumers who are members of membership clubs do not redeem every year. Of which about NIS 6.3 million of expired vouchers, which the Pais (lottery) Club (NIS 2.9 million) and the "Tov," "Hever" and "Together for You" membership clubs did not return to consumers who did not use them

about 77%


of the consumers are not aware of the terms under which it is allowed to stop payments made via credit card

about 20%

of the open complaints at the Israeli Consumer Council in 2018–2020 were closed to reduce the number of unhandled complaints




Audit Actions


 From July 2021 to March 2022 (the Audit Period), the State Comptroller's Office examined government ministries and other entities' actions in consumer protection. The audit was conducted at the Consumer Protection Authority, the Israel Consumer Council, the Ministry of Economy, the Budget Division of the Ministry of Finance (Budget Division), and the Bank of Israel. Supplementary examinations were conducted at the Courts Administration, the Ministry of Justice, the State Attorney's Office, the Competition Authority, and the Government Companies Authority. In addition, meetings were held with experts and researchers from academia, private consumer organizations, the "Hever" membership club for standing army personnel and army retirees and "Hever Consumer" membership club, the "Tov" culture and leisure club for state employees (Tov Club), the "Together for You" membership club, the police funds membership club – "First Of All For You" (the Police Funds) and the "Pais Plus" consumers membership club (Pais Club).

In December 2021, the audit conducted a public participation survey of over 600 respondents. The survey dealt with consumer injustice and its handling by the authorities, consumer awareness, and the scope of consumer injustice in the past two years in purchasing products and services in various fields (Public Participation Survey).

Key Findings





 **The Public's Satisfaction with the Israeli Consumer Council and the Consumer Protection Authority** – by the Public Participation Survey, 76% of the participants, experienced consumer injustice in 2020–2021; 25% of them noted they do not know the main consumer entities. Moreover, over 60% of those who applied to these entities received a response (from the Consumer Protection Authority – 75%, and from the Consumer Council – 65%). Still, less than 50% were greatly satisfied with their treatment.


 **The Consumer Protection Authority Enforcement Extent** – in 2021, the Authority visited 2,664 (about 0.5%) businesses to which the Consumer Protection Law applies (600,000 in number) and opened 514 active enforcement cases (a 50% reduction in the number of cases in 2018). The scope of collectible sanctions imposed on the businesses in these years was NIS 119 million (after reduction), but the collection rate is only 31% (37 out of NIS 119 million). Moreover, the Authority rarely uses its criminal enforcement tools. Thus it opened only three criminal cases in 2020–2021, even though in these




years, there were 13 other tortfeasor companies whose financial sanctions were defined as uncollectible, and they did not have criminal cases opened against them. Therefore, the Authority's ability to deter businesses that violate consumer protection laws has been compromised.

-  **The Consumer Protection Authority's Handling of Consumer Complaints** – in 2020, the number of complaints to the Consumer Protection Authority increased by 58% compared to 2019: about 19,450 complaints compared to about 12,300 in 2019. Even though the Consumer Protection Law mandated the Authority to handle complaints concerning violations of the law or any other harm to the consumer, it does not handle personal complaints and does not assist in the recovery of funds for the consumers that were harmed. This state of affairs and the conclusions emerging from the public participation survey (according to which 26% of respondents reported low satisfaction with the response they received and 30% reported moderate satisfaction) raise concerns that consumers do not have much confidence in the Authority because its actions in handling individual inquiries are not sufficiently focused.



-  **The Israeli Consumer Council's Handling of Consumer Complaints** – by the Council's activity reports for 2018–2020, about 90,000 consumer complaints were received. It was raised that the Council closed about 5,300 complaints that it had begun processing but, for various reasons, was unable to receive a response to its inquiries from the parties involved in the complaint for over 30 days (about 20% of the open complaints). Moreover, although the Council determined that a consultation request must be answered within four days, on average, in 2019–2021, 46% of consultation requests were answered within 30 days, 13% of the requests were answered within 60 days, 8% were answered within 90 days, and the rest (about 32%) – within over 90 days. Less than 1% of consultation requests were answered within four days or less. Furthermore, a satisfaction survey of the Israeli Consumer Council raised that the average level of satisfaction of consumers with the response of the Israeli Consumer Council to their complaints in 2021 was 2.9 (out of 5). A public participation survey raised that 40% attested to low satisfaction and 25% attested to moderate satisfaction with handling their complaints.

-  **Cooperation between the Consumer Protection Authority and the Israeli Consumer Council** – it was found that there is no agreed procedure for the joint work of the Consumer Protection Authority and the Israeli Consumer Council, and the cooperation between them is not conducted according to defined guidelines.

-  **The Bank of Israel's Handling of Consumer Complaints, Fraud, and the Abuse of Credit Cards** – the Bank of Israel did not handle the complaints forwarded to it by the Consumer Council. These complaints contained information about the deception of consumers through credit cards, and scams aimed at the elderly. Moreover, the Bank of Israel did not examine the actions of the credit card companies to stop clearing transactions of businesses that misled consumers or committed fraud using credit cards,



including against the elderly. It was also raised that the Bank of Israel did not form a list of "red flags" and measurable conduct clauses that characterize businesses suspected of committing fraud. It also did not set actions that credit companies must take to establish reasonable suspicion so clearing can be stopped if necessary. The Bank also did not request reports or perform audits of the clearing companies to examine the corporate governance implemented for the suspension of clearing for businesses operating fraudulently and their compliance with this governance, nor did it examine the issuers' handling of consumer requests to cancel transactions, including their policies, systems, procedures, and handling of the resulting credit risk. It was also found that the Bank of Israel did not set individual supervisory requirements for issuers and clearers in the aforementioned areas.

-  **Regulation Regarding Recalls** – in Israel, there is no procedure for the recall of products that regulates the rules and milestones to collect these products and handle them under the International Standard 10393, and there is no uniformity in the instructions for the recall of various products. Also, no regulation requires support for the consumer when issuing a recall – the business is not obligated to compensate the consumer, and the method of collecting the products from consumers is not regulated. Moreover, there are products on the market to which an official standard does not apply. In these cases, the standardization officer has no authority to compel the supplier to issue a recall, and he does not publish the recall notice for these products on the Ministry of Economy website. For these products, the supplier is not obliged to report to the standardization officer, and no one guarantees that the marketing of the product has stopped or that the product has been collected and destroyed.
-  **Consumers' Awareness of Their Consumer Rights** – a public participation survey, among other things, found the following findings: (a) **Cancellation of Credit Card Payments:** about 77% of the respondents are not aware of the terms that allow them to halt credit card payments, about 34% of those who wished to cancel a credit card transaction did not apply to any entity, and about 13% of them did not know who to contact or did not know their rights. It was found that no information was published to the public in the media about the activities of the Public Inquiries Unit in the Banking Supervision Division of the Bank of Israel on the subject of "failure to deliver" and "denial of transaction"; (b) **Disconnection from Service:** About 1,300 complaints regarding disconnection from service were submitted to the Authority and the Council in 2017–2021. By a public participation survey, 48% of respondents are not aware of their rights regarding disconnection from service, including the possibility of receiving remedies without proof of the damage that courts may rule in their favor; (c) **"Delay in the Arrival of a Technician":** According to the survey, 38% of the respondents are not aware of their rights to receive remedies in the event of a delay in receiving service; (d) **Waiting Time for a Response on the Phone:** by the audit team examination, in 22% of the cases the service providers in the Internet sector did not comply with the provisions of the law for answering the phone, and for service providers in the water and sewage sector – in 25% of the cases. According to the public participation survey, 65%



of the respondents are unaware of the obligation to provide a human response on the phone within six minutes.



The Consumer Protection Authority and the Consumer Council Websites' Accessibility to the Public – by the State Comptroller's Office examination, persons with disabilities have difficulty submitting complaints on the websites of the Consumer Protection Authority and the Consumer Council. For example, there is difficulty in filling out the application and the applicant's details on the Authority's website, and when finally submitting the complaint, the applicant did not know whether the submission was successful. On the Council's website, difficulties arose in independently reaching the page where the online complaint is submitted, and in entering several fields of personal details in the complaint form. It was also found that the Council's website is not adapted for browsing with mobile phones. Furthermore, the Authority and the Council websites are only partially translated into Arabic and do not include all the information. In addition, there is no unified and central government website where the consumer can submit their complaint. When a consumer has the option to submit a complaint to two or more government bodies, it must fill in different details about the complaint. This is not in line with the government's policy to reduce the bureaucratic burden.



In the seven sectors in which the Consumer Protection Authority operates, it measurably assessed the effect of its actions and found that the frequency of violations decreased, a desire to move to self-enforcement increased, and the phenomena of scamming were eradicated.

The Police Funds Consumer Club is proactive in guaranteeing exercise of members rights and refunds money to its members for vouchers they did not redeem.

Key Recommendations



Given the low level of consumer awareness of the activities of the Consumer Protection Authority (34%) and the Consumer Council (37%), it is recommended that the Minister of Economy consider to bring their activities to the public's attention.






It is recommended that the Authority and the Council examine the relatively low level of satisfaction in the surveys, and improve the provision of service to consumers.



It is recommended that the Consumer Protection Authority and the Consumer Council examine the lack of coordination and cooperation between them, the consumers inability to distinguish them apart with respect to the handling of complaints, and the complexity of filing a complaint process. It is also recommended that the Minister of Economy,

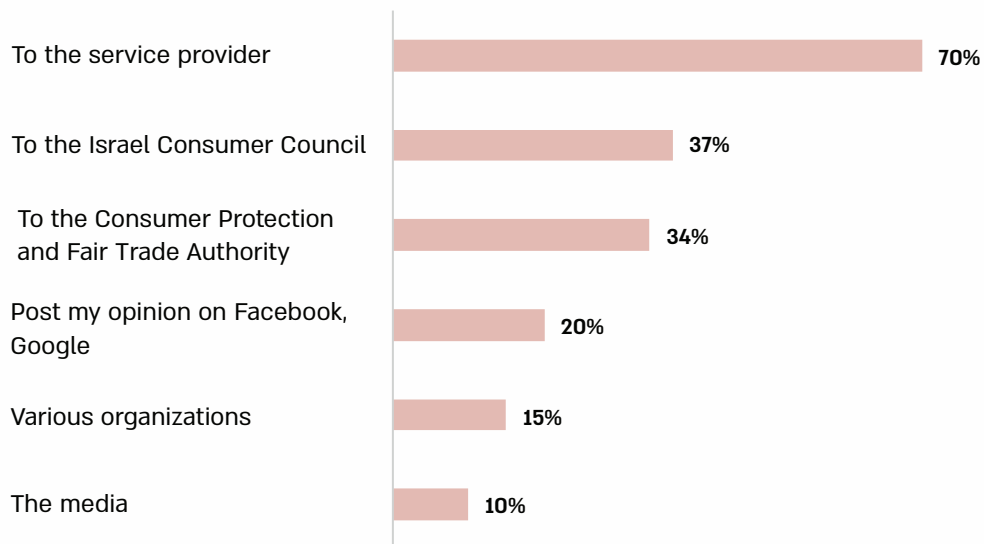


responsible for implementing the Consumer Protection and Council Law, ensure they cooperate. The Minister of Economy should consider ensuring cooperation and coordination and creating interfaces between the Authority, the Council, and other government bodies. Among other things, it is recommended that they consider establishing a unified website for consumer inquiries.

-  It is recommended that the "Pais Club," the "Together for You" membership club, the "Tov Club" and "Hever," consider taking proactive steps (even if there is no explicit legal provision in the law other than the provisions concerning unjust enrichment) within the rules of commercial fairness, and return at least part of the funds paid by the members, estimated at NIS 6.3 million, regarding expired vouchers.
-  The Bank of Israel should use its authority to handle complaints regarding the suspension of charges originating from credit card fraud, particularly in cases of systematic fraud against the elderly and populations deserving support. It is recommended that the Banking Supervision Division establish standard interfaces with the Consumer Council and the Consumer Protection Authority to receive assistance from them in clarifying these complaints and in handling them. It is recommended that the Bank of Israel audit the issuers and clearers regarding the stopping of clearing operations for businesses that engage in deception and credit card fraud.
-  Digital price marking may save costs for retailers and is accepted in different countries of the world. At the same time, it is recommended that the Ministry of Economy, the Consumer Protection Authority, and the Consumer Council ensure that the format to be determined will protect the interests of consumers. They should ensure that changing the marking method will not be used for price manipulations to the detriment of consumers and that the cost savings will also be passed on to consumers. It is also required to consider accessibility for the entire population, particularly the elderly population, the non-Hebrew-speaking population, and persons with disabilities. The Ministry of Economy, the Consumer Protection Authority, and the Consumer Council should continue to ensure that the price marking method complies with the provisions of the Equal Rights Law and, in particular, regarding accessibility for persons with disabilities.



Public Awareness of the Entities to Which a Complaint can be Made About Consumer Injustice (in Percentages)



According to the findings of a public participation survey by the State Comptroller's Office.



Summary

The consumer public is, in many cases, at a disadvantage vis-à-vis the business owners due, among other things, to unfamiliarity with the laws that protect their rights and the difficulty of receiving assistance from entities responsible for implementing these laws.

The audit raised deficiencies in various issues of the service provided to the consumer and the quality of the response provided by multiple government bodies in cases of violation of consumer rights.

The entities responsible for assisting and protecting consumers, including the Minister of Economy, the Consumer Protection and Fair Trade Authority, the Israel Consumer Council, and the Ministry of Economy and Industry, should rectify the deficiencies noted in this report and consider the implementation of its recommendations to prevent harm to consumers, improve the service and raise the level of satisfaction and the level of trust from the entities responsible for the protection of their rights.



Report of the State Comptroller of Israel |
November 2022

Ministry of Transportation and Road
Safety

The Progress of the Light Rail Project in the Tel Aviv Metropolitan Area



The Progress of the Light Rail Project in the Tel Aviv Metropolitan Area

Background

The Tel Aviv metropolis covers about 1,500 square kilometers, about 60 km from north to south and about 30 km from east to west, and is in similar size to major metropolitan cities in Europe. 80% to 90% of travel by motorized vehicles in the large metropolitan cities in Israel (Tel Aviv, Jerusalem, and Haifa) is by private vehicles. Travel using public transport is distributed as follows: about 767 million passengers by bus (about 87%), around 68 million passengers by Israel Railways (about 8%), and about 45 million passengers using the light rail (about 5%).

According to the OECD data, the estimated scope of the transportation infrastructure in Israel is equal to about 50% of the gross domestic product of Israel, compared to about 70% on average in the OECD states. Given the scarce use of public transportation and the low investment in the transportation infrastructure in Israel, the country suffers from the most significant traffic congestion among the OECD countries, and according to the OECD, 2019 results in the loss of about NIS 20 billion GDP.

In 2005–2016, the Israeli governments adopted several resolutions to promote the mass transportation system, intended to improve the accessibility of public transportation and its availability. According to the latest plans, the planned mass transportation system in the Tel Aviv metropolis will consist of three light rail lines, currently in various stages of construction and three metro lines, currently in the stages of planning and legal and planning regulation. At the audit time, the light rail lines are expected to be opened to the public in 2022, 2026, and 2027, gradually, after their construction was postponed several times.



Key Figures

**NIS
48.1
billion**

construction estimation cost of the three light rail lines in the Tel Aviv Metropolitan Area (the Red, Green, and Purple)

**NIS
18.71
billion**

construction estimated cost of the Red Line from October 2021 compared to an estimate of NIS 10.7 billion presented to the government in December 2010

12

updates number in the total budget and the budget items of the Red Line from December 2010 to October 2021

5 years

delay in the opening date of the Red Line from 2017 to 2022

**NIS
11.2
billion**

the estimated total cost of the Purple Line of the light rail in the Tel Aviv Metropolitan Area is about NIS 0.41 billion per km – about 28% higher than the maximum cost of similar projects in other countries (from a World Bank study)

**2026
and
2027**

the years in which the Purple and Green Lines are expected to open, respectively. A postponement of one to two years from the date set in the NTA work plan in 2018 (opening at the end of 2025). As of the audit completion, another postponement may occur in these two lines

**NIS
1.14
billion**

the utility estimated net loss due to a one-year delay in the opening of the Purple and Green Lines (at 2021 prices and at a capitalization rate of 4%) by the calculations of the Ministry of Finance and the State Comptroller's Office

**98
hours per
year per
passenger**

the loss of time due to traffic congestion in Tel Aviv compared to 41 hours in Madrid and Amsterdam and 69 hours in Berlin as of 2021






Audit Actions



From July 2021 to April 2022, the State Comptroller's Office examined the construction project of the light rail lines' progress – the Red, Purple, and Green Lines. The audit was conducted at the NTA – Metropolitan Mass Transit System Ltd. Company (NTA), the Ministry of Transportation, and the Ministry of Finance. A supplementary audit was conducted in Tel Aviv, Ramat Gan, and Bnei Brak municipalities. This audit report joins a series of reports from 2005, 2013, 2014, and 2018 in which the State Comptroller's Office examined NTA's activities.

Key Findings



-  **The Framework Agreement Between Ministries of Transportation and Finance and the NTA Company** – over 20 years after the Company's establishment, the framework agreement between the Ministries of Transportation and Finance and the NTA Company has not been signed. This is even though the government decided in 2010 and 2016 to sign an agreement, and even though the State Comptroller recommended it in its audit reports published in 2013 and 2018.
-  **Postponements in the Date of Operation of the Light Rail Lines** – the completion date of the construction of the Red Line was postponed at least six times for about five years in total (five of the six postponements occurred in 2010–2013 before the beginning of the leading construction works, that began in 2015). The government did not decide on a target date for the Purple and Green Lines operation. The opening of the Purple Line has been postponed from 2025 to 2026, and the opening of the Green Line has been postponed from 2025 to 2027, and another postponement of at least a year may occur due to over a year delay in announcing the PPP project winner, mainly due to the delay of Kfar Shalem evacuation by about a year and a half – from August 2020 to January 2022.
-  **Increase in the Cost Estimate for the Red Line Project** – since the initial cost estimate for the Red Line Project was determined in the government resolution of December 2010 at NIS 10.7 billion, at least 12 updates were made to it, and in at least eight of them the total project cost estimate was updated. In the last update in October 2021, the cost estimate was about NIS 18.71 billion, about NIS 8 billion higher than the original cost estimate (about 75%). Net of the effect of price increases (an addition of NIS 0.671 billion) and a decrease in VAT from 18% to 17% in 2016 (a decrease of NIS 0.128 billion) increased the cost estimate by about NIS 7.46 billion (about 69.7%). There




are many reasons for the deviation in the cost estimate for the light rail lines, the Red, Green, and Purple, that are under construction, including: under budgeting of the contingencies not according to the Transport Projects Procedure and the exclusion of costs from the cost estimate, mainly in the early stages of the project; Absence of linkage to the input indexes baskets; Items that were not included in the project estimate, items that were not priced and items that were underpriced and resulted in shifting between the various budget items.

An International Comparison of the Costs of the Green, Purple, and Red Lines

– it was raised that the cost estimate of the light rail's Purple Line Project is high compared to figures in other countries at 2000 prices (from the World Bank research data) and after standardizing the length of the lines (price effect):





- **The Estimated Cost of the Purple Line** is about NIS 11.2 billion (about NIS 0.41 billion per km), about NIS 4.64 billion (NIS 0.17 billion per km) in 2000 prices, higher by about 26.5% and 133.5% than the maximum and minimum values, respectively, according to similar projects in other countries. I.e., the at grade Purple Line estimate is significantly higher than the comparison figures in the World Bank study.
- **The Estimated Cost of the Green Line** is about NIS 18.3 billion (about NIS 0.47 billion per km), about NIS 7.64 billion (NIS 0.2 billion per km) in 2000 prices, lower by about 5.5% and about 99.4% higher than the maximum and minimum values, respectively, according to similar projects in other countries.
- **The Estimated Cost of the Red Line** is about NIS 18.7 billion (about NIS 0.78 billion per km), about NIS 7.89 billion (NIS 0.33 billion per km) in 2000 prices, in the cost range of similar projects in other countries, and about 23.7% lower and about 113.5% higher than the maximum and minimum values, respectively, according to similar projects in other countries.

I.e., the cost of building an at grade light rail project in Israel is higher than the cost of building similar projects in other countries, and the cost of building more complex light rail projects with a significant underground component is closer to the building cost in other countries.


 **The Documentation of the Changes in the Projects' Construction Budgets** – for five out of nine estimate updates made by NTA to the Red Line in 2014–2020 examined in the audit, the circumstances of the change's updates were found (about 56%). No documentation was found for the circumstances of four updates (about 44%). Full details were attached to two of the five approvals, and for three others – approvals were received via email from the Ministries of Transportation and Finance. In November 2020, the NTA approved a detailed procedure for managing and updating the light rail project budget. The procedure defines the level of authority required for budget approvals in the



NTA, but it does not contain instructions for reporting the budget changes to the Ministries of Transportation and Finance.

-  **The Construction Time of Light Rail Lines in Israel in an International Comparison** – the construction time of the at grade Purple Line in the Tel Aviv metropolis is expected to be significantly longer than the construction time of most of the audited lines with similar characteristics in other countries: about 3.7 months per km on the Purple Line in Israel (a total of about 8 years) compared to about 2.5 months per km on average in other countries (about 48% more than the average on lines in other countries).
-  **Metropolitan Transportation Authority** – even though each light rail line passes through many local authorities in the metropolis and the transportation connections between them are close, there is no Metropolitan Transportation Authority in the metropolis, nor does it have a light rail project administration coordinating everything related to the project. Establishing metropolitan transportation authorities is essential for promoting an overall view of transportation solutions provision, effective response to overall and local needs, coordinating between local authorities, and creating collaborations for promoting public transportation projects.
-  **The Signing of Agreements and Differences in the Existing Agreements Between the NTA, the Ministries of Transportation and Finance, and the Local Authorities** – agreements were signed with the local authorities along the Red Line route, except for Ramat Gan. It was found that drafts have been drawn up, but no agreements have yet been signed with the local authorities along the Green Line route – Holon, Rishon Lezion, and Herzliya. Moreover, it was found that no agreements were signed with the local authorities along the route of the Purple Line. Differences were found in the agreements between the NTA, the Ministry of Transportation, the Ministry of Finance, and the local authorities, among other things on the following: differences in the rate of participation of the NTA in financing the relocation of infrastructure and in environmental development in the different authorities (such as funding of 85% of the cost of relocating of the entire infrastructure in Petach Tikva, funding of 100% of the cost of relocating the infrastructure at the light rail stations in Bnei Brak and 50% between the stations therein, and failure to determine NTA's rate of funding in agreements with other local authorities).
-  **Support for Businesses Along the Light Rail Route** – businesses adjacent to the underground section of the Red Line in Ramat Gan and Bnei Brak area do not benefit from a fund similar to the one established by the Tel Aviv Municipality in cooperation with the Ministry of Finance. They receive no assistance that businesses in Tel Aviv are eligible for, even though a part of the aforementioned fund's budget is a state budget allocated by the Ministry of Finance. This results in inequality between businesses in different municipal jurisdictions.







 **Difficulties and Obstacles in the Interface Between Infrastructure Companies and NTA** – difficulties in coordinating the infrastructure between NTA and the Israel Electric Company (IEC) and other infrastructure companies appear throughout the forums and in various reports about the progress of the Red Line in recent years, and currently regarding the progress of the Green and Purple Lines. From the government approval date of the Red Line execution by the NTA in 2010 until the audit completion in April 2022, no service contract agreements were signed between the NTA, the IEC, and other infrastructure companies, some of which are government companies.



In November 2020, a detailed procedure for the management and updating of the budget of the light rail projects was approved by NTA.

The Ministry of Transportation is preparing to adjust the bus service in anticipation of the light rail Red Line operation.

Key Recommendations

-  It is recommended that NTA, the Ministry of Transportation, and the Ministry of Finance sign the framework agreement and establish working procedures for updating the budget and schedules and reporting thereon. It is further recommended that the Ministry of Transportation, NTA, and the local authorities along the Purple and Green Lines route – Holon, Rishon Lezion, Herzliya, Yahud-Monoson, Or Yehuda, Kiryat Ono, Givat Shmuel, Ramat Gan, Givatayim – which have not yet signed agreements to transfer the right to use the land, will sign the agreements between them.
-  It is recommended that the Ministry of Transportation integrate the schedules and their supervision mechanisms noted in the government's resolutions on transportation projects. It is further recommended that NTA, the Ministry of Transportation, and the Ministry of Finance meet the schedules to prevent delays in the operation of the Green and Purple Lines, to benefit from the operation of the lines, and save additional costs due to delays in the schedules. It is also recommended to consider ways of shortening the work processes for the execution of the light rail projects in the metropolitan area.
-  It is recommended that NTA present a budget estimate as accurately as possible to allow government budget decisions to be based on adequate data enabling the examination of the project's economic viability and accordingly allocating resources.
-  To promote the light rail project and minimize harm to residents along its route, it is recommended that the Ministry of Transportation establish a Metropolitan Transportation Authority in Tel Aviv metropolitan area. Until then, consider alternative ways for interim



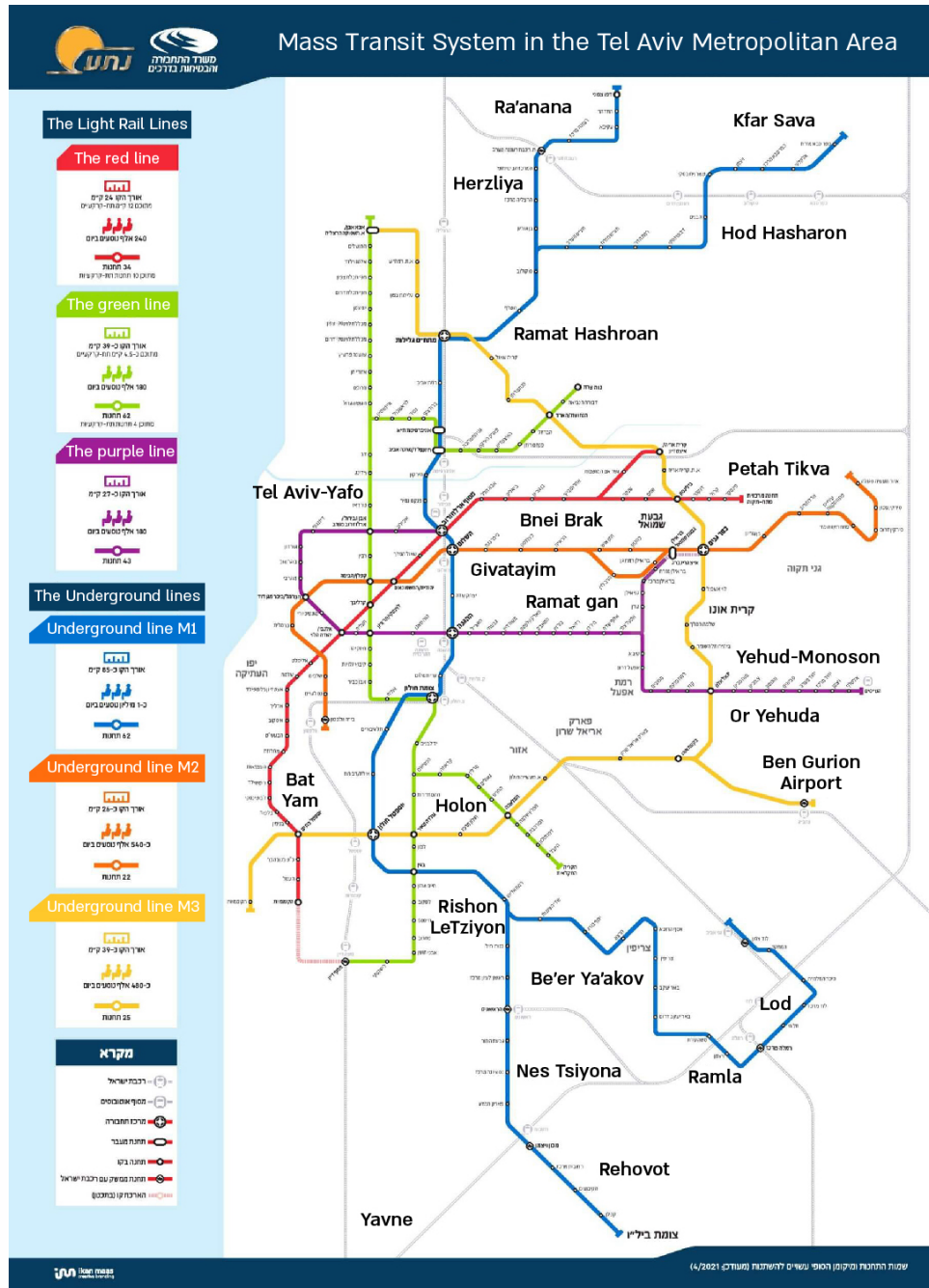
solutions to remove the existing barriers. For example, develop a mechanism to settle disputes between the local authorities and the Ministry of Transportation and appoint a permanent forum consisting of the representatives of all parties. It is further recommended that NTA promote service contract agreements with the IEC and other infrastructure companies to assist the project advancement.



It is recommended that the Ministries of Transportation and Finance examine the light rail project costs disparities of the at grade route compared to other countries, consider ways to minimize them, and use the analysis to support alternatives for future transportation projects, including the selection of the project's route.



Mass Transit System in the Tel Aviv Metropolitan Area



Source: NTA - Metropolitan Mass Transit System Ltd.



Summary

Israel is upgrading mass transit systems by integrating light rail lines in the major metropolises of Tel Aviv and Jerusalem.

The audit found deficiencies in the promotion of the light rail project in the Tel Aviv metropolis. The completion date for the construction of the Red Line was postponed about five years cumulatively over six times, (five of the six postponements occurred in 2010–2013 before the start of the leading construction works, that began in 2015); The opening of the Purple Line was postponed from 2025 to 2026, and the opening of the Green Line was postponed from 2025 to 2027 and another year delay may occur in these two lines; In the Red Line Project, at least 12 updates were made to the project estimate, and in at least eight of them the total project cost was updated; In the last update, the cost estimate was NIS 18.71 billion, about NIS 8 billion, (75%) higher than the original cost estimate and after deducting the effect of increases in price indexes and a change in VAT, about NIS 7.5 billion (about 70%) higher¹; Many changes were made to the Green and Purple Lines amounted to hundreds of millions of NIS, both in the total estimate and in the main budget items of the project; Some of the changes are not documented and were not reported to the Ministries of Transportation and Finance; Differences were found in the rate of NTA's participation in the financing of infrastructure relocation and environmental development in the various authorities; Differences were found in the tools to assist businesses adjacent to the underground sections in different local authorities; There are no service contract agreements between the infrastructure companies and NTA. Examining the cost estimates of the Green, Red, and Purple Lines against international comparative numbers indicate that the cost of construction of an at-grade light rail project in Israel is higher than the cost of its construction in other countries, and the construction cost of more complex light rail projects, in which there is a sizeable underground component, is closer to the cost of establishing them in other countries. Rectifying the deficiencies noted in this report may improve the quality of life of public transportation users in the Tel Aviv metropolis, reduce the difficulties experienced by the metropolis residents on the route of the lines during the construction phase and save high costs for the economy. It is recommended that the Ministries of Transportation and Finance draw conclusions from the segments carried out in the light rail project and apply them to the future planned parts of the light rail and mass transit projects such as the metro. It is also recommended to present the conclusions learned from similar projects along with the requests for approval of transportation projects or budgetary changes in projects by the Ministries of Transportation and Finance.

1 Linkages and rate differences in the project amounted to approximately NIS 0.671 billion and a decrease in VAT from 18% to 17% in 2016 amounted to approximately NIS 0.128 billion. The estimated cost, net of the effect of price increases and VAT, increased by approximately NIS 7.5 billion (about 70%).



Report of the State Comptroller of Israel |
November 2022

Ministry of Transportation and Road
Safety

The Service for Passengers of the Light Rail in Jerusalem – Follow- up Audit



The Service for Passengers of the Light Rail in Jerusalem – Follow-up Audit

Background

Jerusalem is the largest city in Israel. According to data from the Central Bureau of Statistics, in 2020, the city's number of residents was about 950,000. To improve public transportation services for residents and tourists in the city, the government decided in 1999 to establish a mass transportation system¹. The first line of the Light Rail in Jerusalem (the Red Line) began operating in August 2011 and was operated for about ten years by a private concessionaire (the Previous Concessionaire). Starting in April 2021, it will be operated by a new concessionaire, who is also responsible for expanding the Light Rail lines. In 2021, about 37.33 million passengers traveled by Light Rail.

The State Comptroller's Office performed a follow-up audit regarding the rectifying of the deficiencies noted in the report "Service for Passengers of the Light Rail in Jerusalem" (the Previous Audit) published as part of a special report, "The Public Transportation Crisis," in March 2019. The main deficiencies noted included among other things, deficiencies in the frequency, deviations in the travel times Rail, lack of control over the level of passengers crowding on the Light Rail, failure to adapt the ticketing and validation devices to the requirements of the previous concession agreement and inability to provide real-time data to the Ministry of Transport. As part of the follow-up audit, in December 2021, the State Comptroller's Office conducted a public participation procedure (through a survey) and found that about 88% of Jerusalem residents use the Light Rail services as their main means of transportation.

1 See the State Comptroller, **Special Audit Report on the Public Transportation Crisis** (2019), "The Service for Passengers of the Light Rail in Jerusalem", pp. 479–527.



Key Figures

37.33
million

number of passengers who used the Light Rail in Jerusalem in 2021

156,000

estimated average daily passengers, on weekdays, who used the Light Rail in September 2021

88%

rate estimate of Jerusalem residents who use the Light Rail

44%

rate of passengers who were little satisfied with the crowding level in the Light Rail

between
97.5%
and
99.7%

current concessionaire's compliance rate with the Light Rail scheduled frequency in Jerusalem (every 6 minutes), on weekdays, between 7:00 a.m. and 7:00 p.m., the average train journey frequency ranges from 6.02 minutes (approximately 6 minutes and 1 second) to 6.15 minutes (6 minutes and 9 seconds)

between
1,559
and
1,833

telephone inquiries at the current concessionaire's call center from May to September 2021

NIS 2.42
million


the total fines imposed on the current concessionaire from April to September 2021; Compared to about NIS 1.21 million imposed on the Previous Concessionaire from 2018 to April 2021

107
passengers

the total excess of passengers in September 2021 (the maximum number of passengers allowed is 356 passengers, according to 2.75 passengers standing per square meter when all the seats are occupied)



Audit Actions

 From August 2021 to January 2022, the State Comptroller's Office performed a follow-up audit to rectify the deficiencies noted in the Previous Audit. The audit was conducted at the "Jerusalem Transportation Master Plan" Team (the Master Team)² and the Ministry of Transportation and Road Safety. Furthermore, the State Comptroller's Office conducted a public participation process regarding the satisfaction of passengers³ using the Light Rail with the level of service of the current concessionaire.

Key Findings



The Public Participation Process – by the State Comptroller's Office survey, about 88% of Jerusalem residents use the Light Rail, and the passengers using the Light Rail are not satisfied by the sense of security and crowding. Nearly half of the passengers stated that they experienced a high sense of security during the Light Rail ride, 30% said that their sense of security was moderate, and 21% stated that they had a low sense of security. The passengers' sense of security while waiting at the stations is high for 52% of the respondents, moderate for 31%, and low for 17%. About 44% of the passengers stated that the level of passenger crowding is high, and about 27% said they are pretty satisfied with the level of passenger crowding. It should be noted that in the passenger satisfaction surveys from the Light Rail in Jerusalem conducted by the Master Team in December 2021 and March 2022, in the "travel density" parameter, only about 26% answered both surveys that they were satisfied with a "high" degree or more with the level of passengers crowding, and around 43% and 45% answered that they were satisfied to a "low" or "very low" degree with the level of passengers crowding.




The Level of Passengers Crowding on the Light Rail Cars – the prolonged travel time of the Light Rail and the reduction of frequency – increases the crowding, especially during the peak hours. The Previous Audit noted, "The concession agreement states 'normal crowding' in the occupancy of the Light Rail is four passengers per meter. However, the [previous] concessionaire and the Engineer Unit [in the Master Team]

- 2 The Master Team is a professional body operating under the guidance of the Ministry of Finance, the Ministry of Transport and the Jerusalem Municipality on the subject of planning and development of transportation in the Jerusalem metropolitan area.
- 3 The process was carried out through an external company, which prepared for the State Comptroller's Office the required survey for carrying out the process, and then analyzed the results obtained. The State Comptroller's Office published the results verbatim.



disagree with this calculation. According to the Engineer Unit, it is 456 passengers, and according to the concessionaire, it is 535 passengers". The Previous Audit further raised that "within the supervision and control of the Engineer's Unit of the Light Rail, there is no regular and periodic inspection of the crowding level in the railcars." In the follow-up audit, it was raised that the transportation Master Team began to monitor train overcrowding systematically. However, the measurement of compliance with the crowding indicators is still partial. According to the State Comptroller's Office calculations, based on the Master Team's data, in most measurements, the maximum number of passengers on the Light Rail in Jerusalem is over 356 passengers⁴, and over 320 passengers⁵ – the number of passengers, exceeding the maximum threshold established in terms of the new concession agreement, for a maximum level of comfort. In practice, there has been no improvement in the level of crowding of Light Rail passengers since the Previous Audit. The follow-up audit also found that the concessionaire submitted for the Master Team's approval a plan to manage the crowding level threshold as required by the terms of the new concession agreement. After the completion date of the follow-up audit (January 2022), and according to the Master Team's reply to the State Comptroller's Office from April 2022, the plan is under review. The follow-up audit found that the deficiency was rectified to a small extent.

 **Public Inquiries (Complaints)** – the Previous Audit noted that "The Engineer Unit [in the Master Team], supervising the Light Rail service under the concession agreement, does not prepare a periodic report on the scope of public inquiries and complaints addressed to the Ministry of Transportation, the municipality and directly to the [previous] concessionaire, on the length of time the complaint was handled, on the results of the handling, on the characteristics of the complaints, on the rate of justified complaints, on recurring complaints and other indicators as needed." By the follow-up audit, the Master Team presents a monthly report on the number of public inquiries to the concessionaire's call center, whether made via phone or in writing, and categorizes them by subject. However, in the follow-up audit, the Master Team does not refer to the public's inquiries concerning the Light Rail addressed to the Ministry of Transportation and the Jerusalem Municipality in its monthly reports. Furthermore, the Master Team relies on the concessionaire's report regarding the public inquiries received at the call center and does not operate using the "hidden customer" method to assess the level of service independently.

 **Provision of Real-Time Data to the Ministry of Transportation** – by the Previous Audit "At the [previous] audit completion, over three years after the Ministry of Transportation's request to transfer to it real-time data, this demand regarding the Light

4 This threshold is calculated based on 2.75 standing passengers per square meter, when all the seats are occupied. Since the standing area in the car is 44.36 square meters, and there are 56 seats in each car, the maximum number of passengers on the Light Rail (which consists of two cars) according to this threshold is 356 passengers.

5 This threshold is calculated based on 2.34 standing passengers per square meter, with all seats occupied. See also explanation in the previous footnote.



Rail has not yet been implemented and the state has not yet reached an agreement with the [previous] concessionaire on this subject, adversely affecting the passengers' service level." By The follow-up audit, the new concession agreement stipulates the concessionaire provide real-time data to the Ministry of Transportation by mid-2023. As of the follow-up audit end, the data is not being transferred to the Ministry of Transportation in real-time. However, it should be noted that this data is presented at the existing depot centers but not in real-time. The follow-up audit found that the deficiency was rectified to a small extent.



The Frequency of Travel of the Light Rail – by the Previous Audit "As of the audit end [the previous one in April 2018], the frequency of the Light Rail is every 6 minutes [during peak hours which are most of the hours of the day between 7:00 a.m. and 6:00 p.m.]". The Previous Audit also noted, "The number of weekly trips is 4 – less than the number stipulated in the concession agreement [296 instead of 300 in both directions]". By the follow-up audit, the deficiency was rectified to a large extent: the actual average frequency, on weekdays, during most operating hours of the Light Rail, between the hours of 7:00 a.m. and 7:00 p.m., was about the same as the planned frequency and was at about 6 minutes from May to September 2021. The follow-up audit also found that the number of scheduled daily trips of the Light Rail on weekdays (Sundays to Thursdays) increased from 296 to 307⁶ (according to an approved plan from April 2021), reflecting an increase of about 3.7% in the number of scheduled train travels on weekdays. The current concessionaire's compliance rate with the scheduled frequency of the Light Rail in Jerusalem (6 minutes), on weekdays, between 7:00 and 19:00, varies between 97.5% and 99.7%.

The Light Rail Travel Times – the Previous Audit noted that "The actual average travel time of the Light Rail is longer than stipulated in the concession agreement. The average travel time on normal weekdays in 2017, from the starting station at Pisgat Ze'ev to the final station at Mount Herzl, was 46 minutes. The journey in the opposite direction lasted 47 minutes, and the average time for a round trip⁷ was 93 minutes⁸. This is compared to the goal set in the concession agreement: 39 minutes from end to end in each direction and a round trip time of 78 minutes. The difference between the planned round trip and actual time was 15 minutes (about 19.2% more than planned)." The follow-up audit raised that the deficiency has been rectified to a large extent: the actual average travel time of the Light Rail in Jerusalem (from one end to the other) from each departure station from June to August 2021 was about 44 minutes; the actual total round trip time (round trip) was about 87.5 minutes. The follow-up audit also raised that the entire round trip time from June to August 2021 improved by about 5.2 minutes compared to the

6 And even increased to 319 on Thursdays, including night lines, during the summer months only (July and August).

7 The travel time from the departure station to the final station and back.

8 In 2016 the figures were the same.



same round trip time during the Previous Audit and improved by 11.1 minutes compared to the same round trip time in 2012.

Expansions and Extensions to the Existing Red Line and Building the Future Lines (the Green Line and the Blue Line) – the Previous Audit noted that "The continuation of the negotiation process between the Master Team and the concessionaire prevented the promotion of the alternatives presented and caused considerable delay in the construction of the expansions and extensions, as well as a delay in the service expansion of the Red Line to other neighborhoods and areas in Jerusalem"; And that the tender for the establishment of the Green Line is only in the early selection stage. Following the failure of the negotiations with the concessionaire, the operation of the expansions and extensions will be delayed by at least three years more than planned and will delay the expansion of the Red Line service to other neighborhoods and areas in Jerusalem and the provision and improvement of the service to tens of thousands more residents of the city. The follow-up audit found that the deficiency was fully rectified: the JNET Project⁹, which includes the existing Red Line, its extension, and the Green Line that will be established, has been launched under the steps outlined in the new concession agreement. On top of that, along the extended Red Line route, infrastructure work has already begun on all six of its additional work segments for its extension; The next scheduled date for the operation of the Red Line after its extension is June 2023. Regarding the Green Line, at the audit completion, infrastructure works were carried out to construct the Green Line in the work segments set for it.

The Non-Competition Stipulation in the Previous Concession Agreement – the Previous Audit stated that "The non-competition agreement limits the state's ability to improve the public service and respond to the needs of public transportation users according to the development of the city, the population increase, and the changing and updated needs of the passengers, especially due to the constant increase in the Light Rail passengers"; And that "In the agreement with the concessionaire, the state handed over a public resource to private hands, and did not maintain a level of flexibility required as part of the agreement that has been in effect for decades; limiting the implementation of a transportation policy of adding new bus lines and making changes to existing bus lines for the benefit of the public who use public transportation." The follow-up audit raised that the deficiency was fully rectified. In the new concession agreement, there is no non-competition stipulation; thus, there is no harm to the passenger service due to such a stipulation as was in the previous concession agreement. The follow-up audit also found that over a 15-year operating period, as stipulated in the new concession agreement, the state's savings, due to the absence of a non-competition stipulation in the new concession agreement, was estimated at NIS 270 million over the entire operating period.




9 JNET - Jerusalem Net.



The Accessibility of Information on the Website, Payment Applications, and the Accessibility of the Light Rail Facilities – the follow-up audit raised that the Light Rail in Jerusalem website, operated by the current concessionaire, is accessible to the public in Hebrew, Arabic, and English; It is possible to pay for the Light Rail ride using public transportation payment apps (two in number); There are accessibility arrangements for persons with disabilities at the Light Rail stations and inside the train cars.

The Payments Made to the Current Concessionaire for the Operation of the Light Rail Compared to the Payments to the Previous Concessionaire – by the State Comptroller's Office calculation, based on the payments to the current concessionaire for nine months in 2021, the estimated payments for a whole year (2021) was about NIS 73 million; a decrease of about 60% compared to the payments to the Previous Concessionaire – an average annual of about NIS 183 million for the operation of the Light Rail in 2019 and 2020.

Key Recommendations

-  The State Comptroller's Office recommends that the Master Team approve the plan for managing the threshold level of passenger crowding on the Light Rail, submitted by the current concessionaire after the follow-up audit completion. If necessary, also approve the recovery plan presented by the concessionaire as the passengers on the Light Rail in Jerusalem exceeds 356 passengers, and upon the fulfillment of additional conditions, as stipulated in the new concession agreement. Moreover, the Master Team should reduce the train crowding level due to its effect on the travel experience and the quality of service for the passenger.
-  The State Comptroller's Office recommends that the Ministry of Transportation and the Master Team consider the public using the Light Rail services and the needs raised from the State Comptroller's Office public participation process in December 2021. In particular, the crowding level on the Light Rail should be considered. It is further recommended that the Master Team monitor the passengers' level of security on the Light Rail and improve the security of the passengers, despite the high level of satisfaction on this subject in the surveys it conducted, due to the low or moderate degree of satisfaction among about half of the Light Rail passengers in the survey (public participation procedure). It is further recommended that the Master Team improve the communication channels with the operator and the coordination and integration between the buses and the Light Rail following the Master Team survey's results.
-  The State Comptroller's Office recommends that the Master Team and the Ministry of Transportation prepare a centralized document of lessons learned and guidelines for the future, to potentially improve the state's planning and construction of future lines of the



Light Rail in Jerusalem and the execution of other infrastructural projects and for the improvement of service to passengers.



The State Comptroller's Office recommends that the Master Team and the Ministry of Transportation monitor the concessionaire's handling of public inquiries received at its call center, incorporate in its data the inquiries received from the Ministry of Transport and the Jerusalem Municipality, as well as examine the integration of a "hidden customer" audit on their behalf¹⁰, to ensure that the concessionaire handles public inquiries. This is alongside studying its reports on the subject. If necessary, the Master Team and the Ministry of Transportation will present to the current concessionaire the need to improve the response to inquiries.

¹⁰ It should be noted that the Master Team stated in its reply to the State Comptroller's Office in April 2022, that it adopts this recommendation, and that it will integrate a "hidden customer" audit on its behalf, in the set of controls it will perform in the future.



The Rectification Extent of The key Deficiencies Noted in the Previous Audit

The Audit Chapter	The Audited Body	The Deficiency/ Recommendation in the Previous Audit	The Rectification Extent of the Deficiency Noted the Follow-up Audit			
			Not Rectified	Slightly Rectified	Considerably Rectified	Completely Rectified
The travel time of the Light Rail exceeds the stipulated time in the concession agreement	The Ministry of Transportation and the Master Team	The actual average travel time of the Light Rail is longer than stipulated in the concession agreement. The average travel time on regular weekdays in 2017, from the starting station in Pisgat Ze'ev to the final station in Mount Herzl, was 46 minutes. The trip in the opposite direction took 47 minutes, and the average round-trip time was 93 minutes.				
The travel frequency of the Light Rail is not as stipulated in the concession agreement	The Ministry of Transportation and the Master Team	At the Previous Audit completion (April 2018), the frequency of the Light Rail is every 6 minutes (during peak hours which are most of the day, between 7:00 a.m. and 6:00 p.m.) under the plan. The number of trips on a weekday is 4 less than the number stipulated in the concession agreement (296 trips instead of 300 in both directions).				
The travel frequency of the Light Rail is not as stipulated in the concession agreement	The Ministries of Transportation and Finance and the Master Team	The Previous Concessionaire received hundreds of thousands of NIS financial benefits, especially considering the frequency it undertook to comply with the concession agreement. These benefits were expressed in reducing the frequency of trips, changes in the fines mechanism, and the definition of delays.				



The Audit Chapter	The Audited Body	The Deficiency/ Recommendation in the Previous Audit	The Rectification Extent of the Deficiency Noted the Follow-up Audit			
			Not Rectified	Slightly Rectified	Considerably Rectified	Completely Rectified
Level of crowding in the Light Rail	The Ministry of Transportation and the Master Team	The extension of the Light Rail's travel time and the frequency reduction inevitably cause an increase in crowding inside the train car, especially during peak hours. A satisfaction survey conducted by the Administration in 2015 indicates that about 39% of passengers expressed low to very low satisfaction with the crowding on the train.				
Level of crowding in the Light Rail	The Ministry of Transportation and the Master Team	As part of the supervision and control of the Engineer's Unit in the Master Team on the Light Rail, there is no regular and periodic inspection of the level of crowding in the train cars, and the service indicators report prepared by the Engineer's Unit and submitted to the Administration once a month does not include data on the measured crowding.				
Failure to adapt the ticketing and validation devices to the requirements of the concession agreement	The Ministry of Transportation and the Master Team	At the (Previous) Audit completion, over six years after the Light Rail began to operate, the state had not yet definitively approved the conformity of the ticketing system to the requirements of the agreement because a large part of the system tests performed by the concessionaire failed, or was partial or not acceptable to the state. As soon as the Light Rail was put into operation, operational problems and repeated malfunctions in the ticketing and validation devices were discovered, causing considerable harm to the quality of service for passengers.				



The Audit Chapter	The Audited Body	The Deficiency/ Recommendation in the Previous Audit	The Rectification Extent of the Deficiency Noted the Follow-up Audit			
			Not Rectified	Slightly Rectified	Considerably Rectified	Completely Rectified
The concessionaire does not submit data in real-time to the Ministry of Transport	The Ministry of Transportation and the Master Team	At the (Previous) Audit completion, over three years after the Ministry of Transportation requested the concessionaire to provide it with real-time data, this requirement had not yet been implemented, and the state had not yet reached an agreement with the concessionaire on this matter, thus affecting the level of service to the passengers.				
Non-execution of the tender for expansions and extensions to the Red Line	The Ministry of Transportation and the Master Team	In April 2016, the negotiation team reported to the then Director General of the Ministry of Transportation that the negotiations were in the final stages. Still, preparations were made to implement various alternatives in case of failure. Despite the negotiations taking place for two years and despite the substantial differences between the parties, the negotiations with the concessionaire continued for another year until failing, thus preventing the promotion of the presented alternatives and causing a considerable delay in the construction of the expansions and extensions, delaying the service expansion of the Red Line to other neighborhoods and areas in Jerusalem.				
The relationship between the state and the concessionaire	The Ministry of Transportation and the Master Team	The ongoing disputes and transfer of many issues to arbitration indicate poor basic management of the agreements between the Administration and the concessionaire and a poor relationship between them.				



The Audit Chapter	The Audited Body	The Deficiency/ Recommendation in the Previous Audit	The Rectification Extent of the Deficiency Noted the Follow-up Audit			
			Not Rectified	Slightly Rectified	Considerably Rectified	Completely Rectified
Lack of documentation for a shared lesson-learning process	The Ministry of Transportation and the Master Team	There are no references indicating that the Master Team, the Administration, and the Ministries of Transportation and Finance carried out a joint procedure of learning lessons regarding the engagement manner with the concessionaire, the operation of the Light Rail, and the improvement of the service, as well as in the areas of planning, engineering, management, and execution.				
Impairment of passenger service due to the non-competete agreement	The Ministry of Transportation and the Master Team	The non-competition agreement limits the state's ability to improve public service and respond to public transportation users' needs according to the city's development, the population increase, and the changing and updated passenger needs, mainly due to the constant rise in the Light Rail passengers.				



Summary

The Light Rail in Jerusalem is the primary means of transportation in the city. In April 2021, the concessionaire operating the Light Rail in Jerusalem was replaced, allowing the Ministry of Transportation and the Master Team to change essential features in the contract between the state and the concessionaire. As a result, the passengers' service on the Light Rail also changed. The follow-up audit found that most of the deficiencies noted in the Previous Audit were rectified to a large extent, and some were even fully rectified.

However, the crowding of passengers on the Light Rail in Jerusalem has not improved since the Previous Audit was completed, in April 2018, although the control performed by the Master Team on the level of crowding passengers on the Light Rail is conducted monthly. The Ministry of Transportation and the Master Team should improve the service and increase the frequency of the trains to reduce crowding therein. Furthermore, they should improve passengers' sense of security in the stations and trains.



Report of the State Comptroller of Israel |
November 2022

Chapter Three

State Institutions, Government Companies, and Corporations



Report of the State Comptroller of Israel |
November 2022

Bank of Israel

Digital Banking



Digital Banking

Background

In recent years, the financial system has undergone many structural changes originating in significant technological developments, encouraging digital transformation (digitization). Digitization allows various entities to provide financial services, which were previously mostly provided by banking corporations. Thus, the competition expands to various entities from multiple sectors, bringing innovation and streamlining to the banking industry.

Digital banking uses various tools and solutions to benefit consumers of banking services on digital channels – mobile phones and the Internet. The main benefits inherent in digitization are the improvement of convenience, speed, and accessibility to consumers, adjusting banking services to the consumer's preferred mode of consumption, utilizing a minimal structure of operations to lower tariffs, increase competition, efficiency and safety of the payment system, and possibly reducing the use of cash and the black economy.



Key Figures

1

one new bank corporation has been established since the 1970s. It is the only digital banking corporation operating in Israel

11.4%

the average annual profit growth of the five large banking groups net of credit losses in 2014–2021. The yearly profit increased from NIS 10.4 billion in 2014 to NIS 22.1 billion in 2021

only 2

number of entities expected to receive service from the Bureau of Bank Computing Services, established at the cost of NIS 105 million, to encourage competition in financial services by additional players' entry

16

the ranking Israel has received in the banks' digital services customers' satisfaction survey out of 28 leading markets. However, Israel's overall ranking was 27 – one place before last

47.2%

smart transactions¹ rate of all transactions in the Automated Banking Services Ltd. (SHVA) payment system in November 2021. The smart transactions rate of all debit cards worldwide is estimated at 88.6% in the second quarter of 2021

NIS 240 million

cost estimation of establishing a mobility system between banks from the banking system sources

69%

the average discount rate on tariffs for an action execution in the banking system through a direct channel, compared to its execution by a clerk


96%

requests for branch closure rate approved in 2016–2021 in the five big banks

¹ Transactions in smart debit cards that have a smart chip embedded in them containing information attributed only to the card on which it is installed.



Audit Actions

 From October 2021 to February 2022, the State Comptroller's Office examined various aspects of the development of digital banking, including barriers to new technologies integration and the entry of new players, particularly digital banks, and reforms promoted to increase competition in financial and banking services. The examination also focused on the effect of digitization on the public, its scope, the service provided, its accessing methods, and its cost. The examination was conducted at the Bank of Israel, especially at the Banking Supervision Department. Completion examinations were conducted at the Capital Markets, Insurance and Savings Authority (Capital Market Authority), the Securities Authority, the Budget Division at the Ministry of Finance, and the Agency for Small and Medium Business at the Ministry of Economy.

Key Findings


-  **The Banking Mobility Reform** – the Banking Mobility Reform eases the transition between bank accounts and may increase the consumer's bargaining power and the ability of new players to enter the market. However, the documents used for its promotion did not indicate a distinct bureaucratic barrier in the transition between bank accounts, the rate in Israel is 2.5% compatible with the standard rate worldwide. Furthermore, the Ministry of Finance and the Bank of Israel promoted the reform without contending with various barriers that make it difficult for the public to use the mobility system, including psychological barriers, poor financial education, and the lack of significant differences between banks.
-  **Establishment of Digital Banks in Israel** – it was raised that in 2017–2021 the cumulative volume of the world's leading digital banks increased from 5.25 million users to about 75 million users, and their cumulative income increased in 2018–2020 from USD 484 million to USD 1,570 million. By the end of 2021, no independent digital banks will operate in Israel. However, existing corporations have upgraded their systems to support various services and actions on their website and apps. In addition, in June 2017, a large banking corporation established a digital bank platform operating through an app under the permit for a digital branch received from the Banking Supervision. This platform mainly serves a young clientele in basic bank operations, but it is expected to be expanded to provide additional services and products later. It was further raised that establishing the new digital banking corporation was 24 months from the granting date of a limited bank license that was not in effect until the license was obtained in January 2022.




- Instant Payment System** – according to BIS (Bank for International Settlements), as of 2021, there are over 60 instant payment systems worldwide. Some countries plan to apply such systems in the coming years. It was raised that although the immediate payment system participants complied with the Bank of Israel order and prepared to receive payments through it, at the audit completion, 2 of the 11 banks operating in Israel allowed their clients to make payments through it. An instant payment system increases the redundancy in making fast and final payments in the economy. The system enables the clearing of billions of NIS in advanced payment means and increases the convenience, speed, and efficiency for the public while reducing the use of cash and supporting the payment of low amounts. Still, the use scope of the system is 3.62% of all activities in the "credits, charges and payments transfers" system, which is low compared to the potential of use thereof.
- EMV Technology** – EMV technology is used to secure transactions through smart debit cards and to replace old technology (magnetic strips). The implementation of EMV technology in Israel is relatively low compared to performance worldwide (a difference of about 54 percentage points from the world's average level as of the second quarter of 2021) even though entities within the Bank of Israel and outside have reported over the last decade that it should be promoted. Delays in implementing the technology have led to delays in implementing new payment technologies used for years in many countries and benefit consumers, especially using digital wallets. It should be noted that from March 2020, the gaps were reduced following an outline for accelerating the implementation of the standard published by the Banking Supervision Department. As of November 2021, about 73% of the EMV system transactions are smart transactions, and about 47% of transactions in the Automated Banking Services Ltd. (SHVA) payment system is smart transactions.
- Collection of Information in Digital Wallets and Payment Apps** – according to the SHVA Company data, the value of transactions carried out in digital wallets and payment apps increased from about NIS 2.4 billion in the first quarter of 2020 to NIS 5.4 billion in the third quarter of 2021. However, collecting information on customers and the use thereof is not regulated in all the entities operating digital wallets, especially those engaged in retail.
- Digital Literacy** – it was raised that a third of 20-year-old Israelis and up cannot perform banking operations on direct channels without the help of a bank clerk. Low success rates were documented among the older population (more than half of the 65-year-olds), in the Arab sector compared to the Jewish sector (a difference of 20 percentage points; more than half the Arab sector), and among women compared to men (a difference of 9 percentage points).
- Closing Branches in Commercial Banks** – closing branches is also typical in OECD countries. The decrease in commercial bank branches per 100,000 adults in the OECD countries has been going on longer than in Israel. Still, the number of branches in Israel



per 100,000 adults was low compared to the average amount of branches in the OECD countries throughout the past decade. Thus, in 2020 in Israel, there were 16.2 branches per 100,000 adults compared to 18.3 on average in OECD countries.


 **The Profitability of the Banking System and the Benefits to the Public** – digitization has significantly improved the banking services' diversity and efficiency for consumers and reduced the costs of fees. Moreover, digitization reduced the banks' cost of salaries and associated expenses and increased the profits of the five largest banks by 10% in 2014–2021. Still, it did not decrease credit margins, and its earnings over the past few years have increased consistently from NIS 10.4 billion in 2014 to NIS 22.1 billion in 2021, according to the growth of the bank credit portfolio. This indicates centralization in the banking industry and a lack of sufficient competition, casting doubt on whether digital efficiency has benefitted the public. This requires the Bank of Israel and the Banking Supervision Department therein to increase competition in the digital age in the banking industry for digital efficiency to be more significantly expressed in reducing costs for the consumer.

 **Public Satisfaction with the Digital Services** – the Israeli public is satisfied with digital services even in an international comparison, and in all banks, high satisfaction rates were documented (91% on average). Nevertheless, digital streamlining did not increase the fairness degree the public attributes to the local banking system. The public is still unsatisfied with it, as is evident from meager satisfaction rates with the bankers' initiative in proposing services to reduce costs (35.5% on average) and in creative solutions that suit customers' needs (33.5% on average.)




The State Comptroller's Office commends the Banking Supervision's initiatives for promoting open banking, identifying and removing entry barriers by adapting regulation to establish new banks, especially digital banks, and increasing financial education and digital literacy in the public through the banking system and promoting collaborations with various government entities.


Key Recommendations

 It is recommended that the Ministries of Finance and Justice, the Bank of Israel, and members of the committees responsible for promoting competition and innovation in the banking industry, consider the range of measures the banking system is required to implement when deciding on new steps, and ensuring they integrate effectively. It is further recommended that the Banking Supervision Department formulate a comprehensive periodic plan with timetables to promote competition and innovation in the banking industry in collaboration with the banking corporations. The plan will be published, express the





legislative and regulatory requirements and support the preparations for the banking system.

 Given the continuation procedures for regulating payment services, the delay in publishing the Committee conclusions from the Financial Supervision Structure Examination (currently operating and tasked, among other things, with addressing this matter), alongside the lag compared to the status worldwide, in the arrangement of the operations of payment providers and the arising implications from aspects of competition, innovation, and the payment system efficiency, it is recommended that the Ministry of Finance promote the regulation.

 It is recommended that the Banking Supervision Department remove barriers to establishing new digital banks in Israel and examine, in cooperation with the relevant regulators, the Money Laundering and Terror Financing Prohibition Authority, the foreign digital banks, the regulatory barriers that prevent the latter from entering Israel and the ways to reduce them, to expand competition in the domestic market.

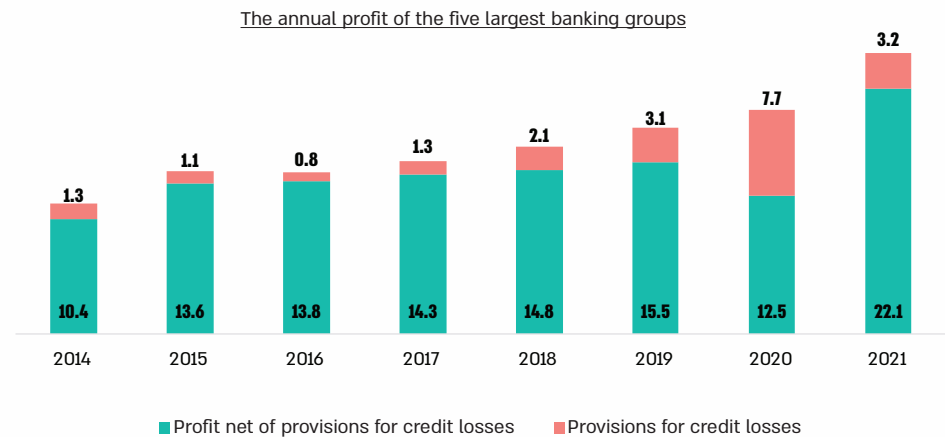
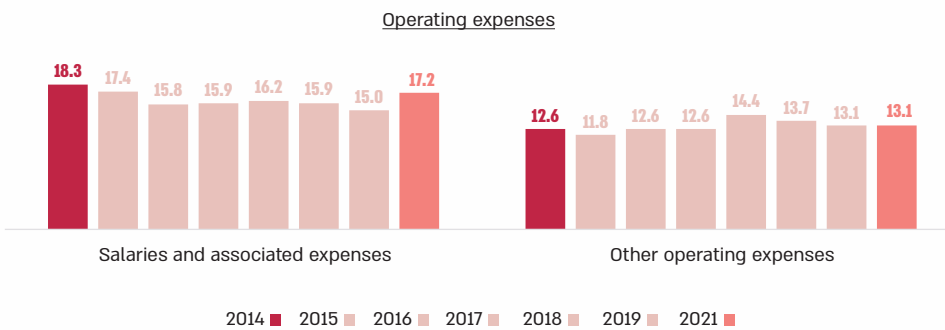
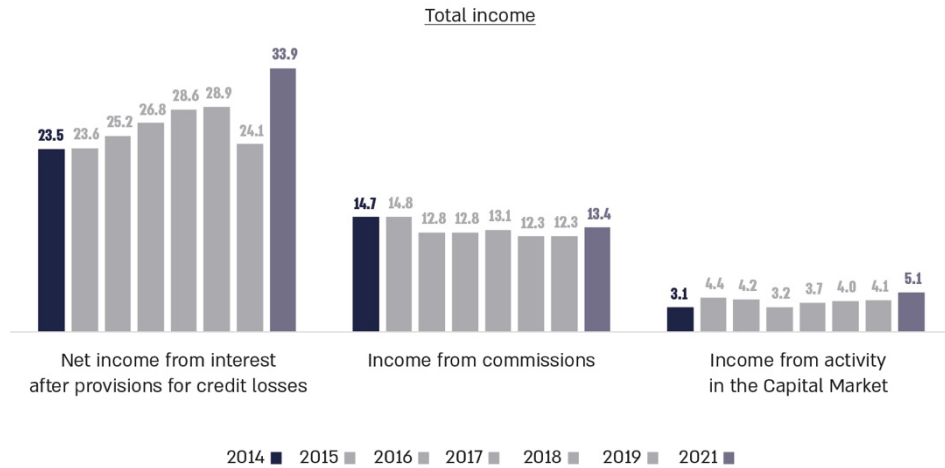
 It is recommended that the Bank of Israel promote the integration of the EMV standard in the economy in coordination with the Ministries of Finance and Economy to reduce the gaps between Israel and other countries and support the entry of advanced payment methods.

 It is recommended that the Ministry of Finance and the Capital Market Authority promote financial education in Israel through a comprehensive solution – a detailed plan including the resources available to the regulating body. Given the high rate of those having difficulty in executing actions in direct channels (31%) and the rate of digital illiteracy among adults in Israel (16%), it is recommended that the Banking Supervision Department examine, in collaboration with the banking system, the barriers preventing them from carrying out these actions and instruct the banks to provide targeted assistance to clients having difficulties. Verifying that the performing systems are user-friendly and easy to operate is recommended, even for those with only partial digital literacy.

 Given the importance of consumer aspects in the banking system, including fairness towards customers, it is recommended that the Banking Supervision Department determine timetables for implementing the fairness assessment project throughout the banking system. It is further recommended that the Banking Supervision Department contacts the entities that collect data and information on consumer issues concerning the banking system and examine the integration of this information in the assessment to optimize the process.

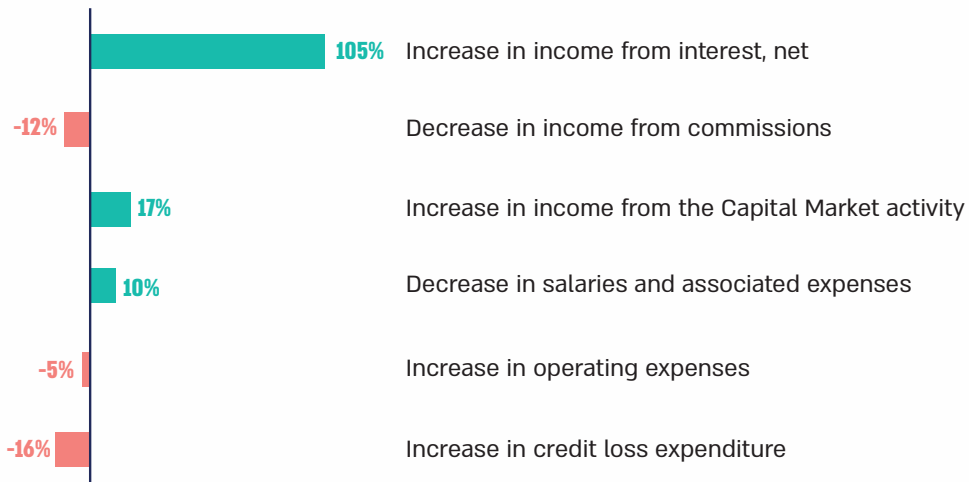


The Change in Income, Expenses, and Profit of the Five Major Banking Groups Together and Their Effect on the Change in Cumulative Profit in 2014–2021 (in NIS Billion)





The factors affecting the change in profit accrued throughout the period



According to the Banking Supervision Department data processed by the State Comptroller's Office.

Summary

Digital banking includes various tools and solutions to benefit consumers by accessing banking services comfortably, quickly, and securely on digital channels. Therefore, it should be ensured that digitization considers populations deserving of support, with no literacy required to navigate the financial and digital world. The frequent changes in the financial system, originating in significant technological developments, require adaptation of the regulation. The regulation should be comprehensive, relevant, and flexible to promote innovation, remove barriers and create certainty. Digital banking facilitates increasing competition in a conservative and centralized market and reduces the black economy. It is recommended that the Bank of Israel and the Ministry of Finance direct it to encourage the entry of local and international entities to streamline the industry, benefit consumers, and further contribute to reducing the cost of living in Israel.



Report of the State Comptroller of Israel |
November 2022

Israel Postal Company Ltd.

**Israel Postal
Company Ltd. –
International Mail
Handling – Follow-
up Audit**



Israel Postal Company Ltd. – International Mail Handling – Follow-up Audit

Background

The Israel Postal Company Ltd. is a government company wholly owned by the state. It began operating in March 2006 under a license granted by the Postal Law, 1986 (the Company). The Company is subject to the supervision of the Government Companies Authority, and some of its activity is also subject to the supervision of the Ministry of Communications. In recent years, the Company has been facing a significant reduction in the volume of letters sent through it and, on the other hand, a significant increase in the volume of postal items and packages that Israeli citizens purchase on online trading sites abroad being sent to their destination through the Postal Company.



Key Figures

46 million
postal
items

the annual volume of postal items sent from abroad in 2021 in the framework of online trade

threefold

the volume growth of the shipment imports of international online trade in 2012–2019

73.4%

the rate of justified complaints on the Postal Company arbitrated by the Ombudsman at the State Comptroller's Office in 2020

NIS 116
million

the scope of taxes collected by customs for online trade items in 2021 (until November)

5,000
postal
items per
hour

sorted by the automatic sorting machine that entered service in 2021

20,253
tons

the total weight of postal items sent from abroad in 2021 in the framework of online trade


359
grams

the average weight of a package in 2021. More than three times its average weight in 2010 (98 grams)

tens
of percent

the decreased rate in operating profit from incoming international mail in 2019–2020

Audit Actions

 The State Comptroller's Annual Report 67A, published in 2016 (the Previous Audit), dealt with the Postal Company's handling of international mail. From August to December 2021, the State Comptroller's Office examined the rectification of the deficiencies, the implementation of the recommendation noted in the Previous Audit, and rectifying some of the deficiencies published in another audit report from 2018¹ (the Previous Audit From 2018). The audit was conducted at the Postal Company, the Customs Administration in the Israel Tax Authority, and the Postal Administration in the Ministry of Communications.

¹ The State Comptroller, Annual Report 69A (2018), "The Government's Handling of the Increase in Online Commerce".



Key Findings



A Monitoring System for Postal Items Arriving in Israel – the Previous Audit raised that the Company did not operate a system for monitoring postal items and mailbags as stipulated in the license instructions. By the follow-up audit, as of the audit completion, the deficiency had not been rectified, and the Company had not fully implemented the monitoring system as required by the license.

Implementation of the "Ben Gurion Airport Module" for Integrity Controls – the Previous Audit raised that the registration of the airmail bags arriving from abroad is carried out manually, making it difficult to track the bags. By the follow-up audit, the deficiency has been slightly rectified. Currently, the Company's employees manually enter into a computerized system the containers and pallets numbers loaded onto the trucks on their way to the Modiin Trade Center, and not through computerized indicator reading, enabling adequate computerized integrity control, and by reading a barcode indication, on their arrival at the Modiin Trade Center. It was further raised that the development of the "Ben Gurion Airport Module" for computerizing the records carried out at the Modiin Trade Center was not completed.


The Handling of International Mail Inquiries by the Postal Company Customer Service Department – the Previous Audit noted a sharp increase in international mail inquiries. By the follow-up audit, the number of international mail inquiries to the Postal Company's customer service increased by more than fivefold in 2018–2021, from 43,895 inquiries in 2018 to 235,612 in 2021. The Ombudsman at the State Comptroller's Office received 2020–2021 hundreds of customer complaints about the level of service, particularly regarding the operation of mail delivery centers that are far from the residents' homes.


Accounting Presentation in the Financial Statements of Incoming and Outgoing International Mail – the Previous Audit raised that the Company's financial statements do not present the profitability of the various segments in the international mail activity. By the follow-up audit, the deficiency was not rectified. The data in the Company's financial statements are presented without fully detailing the various segments of the Company's activity; in the incoming international mail segment, the income and expenses data are not presented, while in the outgoing international mail segment, only the expense data are presented.

The Rate of Operating Profit and the Transition to Cargo Deliveries – it was raised that in 2019–2020 there was a decrease of tens of percent in the operating profit rate in the incoming international mail segment. Moreover, the operating profit rate from cargo deliveries is significantly lower than that of postal deliveries, resulting in financial harm estimated by the Company at tens of millions of NIS per year. It should be noted



that according to the Postal Company, the decrease in operating profit in 2019–2020 was affected, among other things, by the Covid-19 crisis and by the growth of about 20 million items sent in 2019 compared to 2020.

 **A Dedicated and Adapted Information System for Managing Audits in the Postal Administration in the Ministry of Communications** – the Previous Audit raised that the Postal Administration in the Ministry of Communications does not use a dedicated information system to manage its audits of the Postal Company and the other bodies providing similar services under its supervision. By the follow-up audit, the deficiency was not rectified. The Ministry has not implemented a dedicated system for managing its audits on the postal services provided by all the permit holders under its supervision.

 **Damage to Postal Items Arriving from Abroad** – the Previous Audit noted a phenomenon of theft of postal items. By the follow-up audit, the phenomenon continues. The data provided by the Security Department to representatives of the State Comptroller's Office indicates that from January 2017 to the end of 2021, 98 investigations and inspections took place in the Company's Security Department (about 20 incidents per year on average) that dealt with damage to mail from abroad.



Receipt of the Postal Items at the Post Office in Ben Gurion Airport – the Previous Audit raised that postal items are held for an extended time at the post office in Ben Gurion Airport before their processing begins. By the follow-up audit, the deficiency has been rectified to a large extent, and the postal items release procedures at the Company's terminal in Ben Gurion Airport and their handling have improved.

Transport of EMS Items² – the Previous Audit noted the Postal Company's inefficiency in transporting EMS items, manifested in repeated and unnecessary trips to transfer the items. By the follow-up audit, the deficiency has been fully rectified. Currently, no repeated and unnecessary transportation trips are made. EMS items are delivered from Tel Aviv to the courier unit in the Modiin Trade Center, and from there, they are delivered directly to the recipients' homes.

The Online Trade Center – the Previous Audit From 2018 raised that in about two-thirds of the stations in the Modiin sorting center, the typing of the packages' details and their sorting are done manually. By the follow-up audit, the deficiency in the typists' work procedure has been rectified to a large extent. The mechanized sorting of online trade items significantly improves the speed and efficiency and reduces the probability of human errors and the use of manpower required, thus considerably saving financially.

2 Express Mail Service; Express international post.



Inspection of the Legality of Importing Postal Items and Goods Prohibited for Importation – the Previous Audit raised that the Customs officials carry out limited and manual sample inspections of postal items and that the Customs Department has no prior information about the contents of the postal items sent to Israel through the Postal Company. By the follow-up audit, the deficiency has been rectified to a large extent. Given the transition of about 50% of international mail traffic to cargo shipments, the Postal Company sends Customs preliminary information on these and other shipments through the "World Gateway" system³. It enables more efficient analysis of the shipment data in the risk management system to examine whether it is necessary to check the shipment. However, it was raised that the sample tests scope and the actual opening of the packages by the Customs personnel has decreased compared to previous years. Thus, in 2021 Customs checked about 21,500 (0.03%) out of about 60 million packages.

Computing and Interface Aspects Between the Postal Company and the Customs Department – the Previous Audit raised that the Postal Company did not allocate the necessary resources to connect to the "World Gateway" system and that Customs did not have information on the content of the incoming mail. By the follow-up audit, the deficiency has been rectified to a large extent. The management of the Postal Company's incoming international mail system is currently carried out mainly⁴ (to about 80%) by the "World Gateway" system. However, it was raised that the management of the outgoing international mail system is not done through the "World Gateway" system.






Collection of Taxes for Postal Items – the Previous Audit raised that the lack of inspection by the Customs Department results in a potential tax loss of about NIS 200 million per year. By the follow-up audit, the deficiency has been rectified to a large extent. Currently, tax is collected for all items imported into Israel using the cargo method and postal items sent by regular postal delivery for which preliminary information is available. Therefore, currently, the tax loss has decreased. From the data provided by the Customs Division to the representatives of the State Comptroller's Office, the scope of tax collection for incoming international mail traffic has increased over the past few years and was about NIS 116 million in 2021 (until November).

3 A computerized system for foreign trade management that enables electronic information sharing with customs.

4 With the exception of unmonitored postal items, postal items to which the sender did not attach preliminary information and postal items with an incorrect barcode.

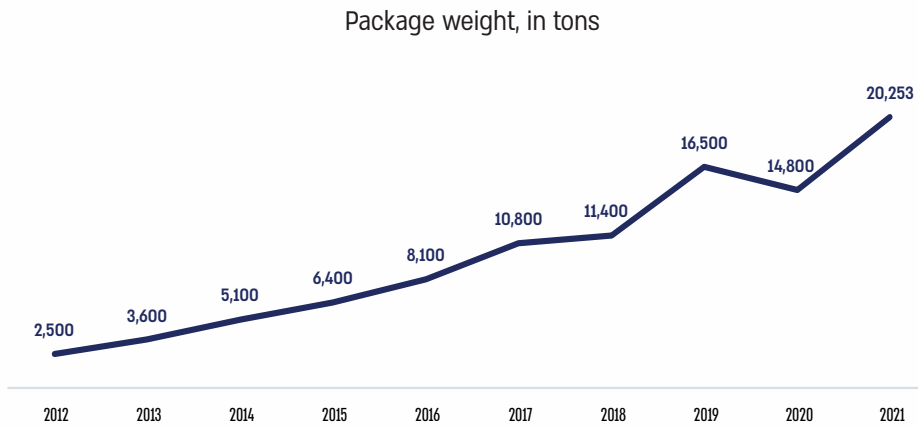


Key Recommendations

-  **A System for Monitoring Postal Items Arriving in Israel** – the Postal Company should implement the monitoring system as required by the license.
-  **Implementation of the "Ben Gurion Airport Module" for Integrity Controls** – it is recommended that the Postal Company complete the development of a computerized system that enables full control of the integrity of the containers and pallets that are loaded onto trucks at Ben Gurion Airport until they arrive at the Modiin Trade Center. It is also recommended that the Company complete the transition to a fully mechanized sorting method to the extent possible.
-  **Referral of Postal Items to Remote Delivery Centers** – given the many complaints about a referral to remote delivery centers, it is recommended that the Postal Company prevent the recurrence of the phenomenon of referral to remote delivery centers, which mainly affects the elderly and persons with disabilities, who find it challenging to reach centers far from their homes to collect postal items they ordered.
-  **Accounting Presentation in the Financial Statements of Incoming and Outgoing International Mail** – given the considerable importance of the trade sector, from which the revenue rate is about 39% of the Company's total revenue, and given the international mail activity in the Company, it is recommended that the Company consider presenting in its financial statements the financial results of the international mail sector, while separating the incoming mail sector from the outgoing mail sector.
-  **Aspects of Computing and Interface Between the Postal Company and the Customs Department** – it is recommended that the Tax Authority and the Postal Company connect the outgoing international mail system as well to the "Global Gateway" system.



The Weight Increase of Incoming International Mail, 2012–2021



Source: data from the postal company's finance department.

The Extent of Rectification of the Key Deficiencies Noted in the Previous Audit

The Audit Chapter	The Audited Body	The Deficiency/ Recommendation in the Previous Audit	The Rectification Extent of the Deficiency in the Follow-Up Audit			
			Not Rectified	Slightly Rectified	Considerably Rectified	Completely Rectified
Receipt of postal items at the post office terminal in Ben Gurion Airport	Israel Postal Company	The Previous Audit noted delays in handling and releasing the postal items at the Company's terminal at Ben Gurion Airport.				
Transport of EMS items	Israel Postal Company	The Previous Audit raised that the Postal Company's handling of the transportation of EMS items is inefficient, expressed in the performance of repeated transportation trips.				



The Audit Chapter	The Audited Body	The Deficiency/ Recommendation in the Previous Audit	The Rectification Extent of the Deficiency in the Follow-Up Audit			
			Not Rectified	Slightly Rectified	Considerably Rectified	Completely Rectified
The Online Trade Center	Israel Postal Company	The Previous Audit from 2018 raised that the process for typing the package details and sorting was still done manually in about two-thirds of the stations.				
Damage to postal items arriving from abroad	Israel Postal Company	The Previous Audit noted the phenomenon of theft of postal items.				
Inspection of the legality of the import of postal items and goods that are prohibited from import	The Customs Administration in the Tax Authority	The Previous Audit raised that the Customs officials carry out limited and manual checking of postal items and that the Customs Division does not have prior information about the contents of the postal items entering Israel through the Postal Company.				
Inspection of the legality of the import of postal items and goods that are prohibited from import	Israel Postal Company	The Previous Audit raised that the Postal Company did not allocate the necessary resources to connect to the "World Gateway" system. Therefore, Customs did not have advance information on the contents of the incoming mailbags, and its control was not done according to any criteria.				
Collection of taxes for postal items	The Customs Administration in the Tax Authority	The Previous Audit raised that the lack of inspection by the Customs Department resulted in a possible tax loss of about NIS 200 million per year.				



The Audit Chapter	The Audited Body	The Deficiency/ Recommendation in the Previous Audit	The Rectification Extent of the Deficiency in the Follow-Up Audit			
			Not Rectified	Slightly Rectified	Considerably Rectified	Completely Rectified
Implementation of the "Ben Gurion Airport Module" for integrity controls	Israel Postal Company	The Previous Audit raised that the airmail bags arriving from abroad are manually registered, thus making it difficult to track them.				
A system for monitoring postal items arriving in Israel	Israel Postal Company	The Previous Audit raised that the Company did not operate a system for monitoring postal items and mailbags as stipulated in the license provisions.				
Customer Service Department at the Postal Company handling of inquiries about international mail	Israel Postal Company	The Previous Audit raised that the Customer Service Department's handling procedure for registered postal items arriving from abroad is not managed in the CRM system as required and that those who handle inquiries in the Southern and Tel Aviv districts do not directly answer inquiries from abroad.				
Accounting presentation in the financial statements regarding incoming and outgoing international mail	Israel Postal Company	The Previous Audit raised that the Company's financial statements do not present the profitability of the various segments in the international mail activity.				



Summary

The trade sector and international mail traffic have significantly grown in recent years. For example, in 2019, about 68 million online trade items were sent from abroad to Israel, over three times the number in 2012 (about 22 million online trade items).

Over the years since the publication of the Previous Audit, the Postal Company has made comprehensive changes to the entire operating system of international mail, mainly establishing the online trade center in Modiin. These changes helped it to meet the growing volumes of international postal item traffic.

However, the service level is still not as satisfactory as expected. There are still deficiencies: the implementation of the monitoring system, the control procedures in the process of transferring the postal items from Ben Gurion Airport to the Modiin Trade Center, sorting the postal items manually, connecting the outgoing international mail system to the "World Gateway" system" and checking the traffic of online trade items by Customs.

It is recommended that the Postal Company, the Customs Administration in the Tax Authority, and the Ministries of Communication and Finance rectify the deficiencies noted in this audit and consider implementing the recommendations accordingly.



Report of the State Comptroller of Israel |
November 2022

Israel Electric Company Ltd.

Streamlining at the Israel Electric Company Ltd.



Streamlining at the Israel Electric Company Ltd.

Background

Israel Electric Company Ltd. (IEC) is a government and public company, and the government holds about 99.85% of its shares. The Company produces electricity and supplies it to all sectors of the Israeli economy . Until the last decade, the electricity sector was characterized by high concentration. The industry was operated mainly by IEC, which monopolized all electricity sectors. The State Comptroller's Office raised in a previous¹ audit that IEC's activities were characterized by inefficiency in terms of personnel, development expenses, and operating costs. This affected the efficiency of the electricity sector in general and IEC's financial resilience in particular. In 2018, the government decided on a reform in the electricity sector and a structural change in the Israel Electric Company, among other things, to streamline the industry, encourage competition, and strengthen IEC's financial stability.

1 State Comptroller, Annual Report 66A (2015), "Opinion on Aspects of the Electricity Sector's Activity", pp. 463-543.



Key Figures

**NIS
7.1
billion**

the reform cost (in present values), of which NIS 6.4 billion as retirement awards to retiring employees and as pension allowance increase for all Company employees

**NIS
2.72–2.78
billion**

of the total benefits of about NIS 6.3 billion was expected from the reform implementation in the first 8 years, eventually about 44% will not be received due to high benefit estimates at the reform adoption time

**1,229
permanent
employees**

the number of permanent employees who retired by December 2021 out of a retirement goal of 1,800 employees who are expected to retire by the reform end in 2025 (IEC increased the retirement goal by another 200 employees above the reform goals)

**547
temporary
employees**

additional temporary employees in 2022 in excess of the reform goal. In 2023 their number will reduce to 458 and in 2024 to 82. The estimated cost of employing the additional employees in 2022–2024 is about NIS 271.7 million

**NIS
4.85
billion**

salary expenses in 2021², about 21% of the Company's total expenses this year and about 28% of the Company's expenses without fuels

2,380 MW

so far, three stations with a capacity of 2,380 megawatts have been sold, as stipulated in the reform and according to the set schedules. This is out of 4,500 megawatts that are planned to be eventually sold as part of the reform by 2023

9.4%

the increased rate in operating costs and investment renovations per megawatt capacity in the IEC's power stations (not including the stations sold) in 2017–2021


**196 minutes
of non-supply**

in 2021, an increase of about 28% compared to 2017. I.e., a deterioration trend continuation of the non-supply time since 2013, even though the reform was supposed to increase investments in the electricity network and reduce the non-supply time, as presented in the reform benefit estimates



² The salary cost of NIS 4.85 billion includes also the cost of hiring the employees who were seconded to the buyers of the Company's power stations as part of the reform, and who were sold up to this year. IEC bears the cost of their employment. Deducting the salary costs of these employees reduces the total salary cost to about NIS 4.81 billion.



Audit Actions


 From May to December 2021, the State Comptroller's Office examined the efficiency and streamlining of the IEC since the beginning of the reform implementation. Alongside with a forward-looking view, examined additional streamlining measures that were set in the reform, including the sale of IEC's power stations. The examinations were conducted at the IEC, the Ministry of Finance in the Budgets Department, the Salary and Employment Agreements Department, the Ministry of Energy, the Electricity Authority, and the Government Companies Authority. Completion examinations were conducted at Noga – Israel Independent System Operator Ltd. company.


Key Findings


- 
-  **Estimates of the Reform Cost and Benefits** – the cumulative quantitative benefit from the reform in the first eight years (the Reform Years) was estimated by the Budget Department of the Ministry of Finance (Budget Division) at NIS 6.3 billion (NIS 5.1 billion in current value). The expected benefits consisted of a reduction in IEC's share in the production segment (NIS 2.32 billion), IEC's focus on activity in the network segments (NIS 1.25 billion), and an improvement in IEC's financial situation³ (NIS 2.75 billion).
 - **Reduction of IEC's Share in the Production Segment** – it was raised that as of the audit date, about 64%–68% (approximately NIS 1.51–1.58 billion of NIS 2.327 billion) of the Budget Division benefits estimates from the reduction of IEC's share in the production segment will not be received in the following eight years of the reform; as the sale of the Reading Power Station was not executed and the Budget Division's benefit estimates were not accurate.
 - **IEC's Focus on Activity in the Network Segments** – regarding benefits of about NIS 1.252 billion presented by the Budget Division to the government, it was found that approximately NIS 0.935 billion will not be realized in the coming years due to inaccuracies in the Budget Division's estimate. As of the audit completion, approximately NIS 0.27 billion, expected to be received in 2021–2022, were not received.


³ The improvement component in the IEC's financial position was examined in the State Comptroller's report on the management of debt in the IEC published in 2021.




-  **Reducing Non-Supply Minutes on the Network** – in 2020, about three years after the reform adoption, the number of non-supply minutes on the network was 142 minutes, i.e., an increase of about 44% compared to 2017. This reflects the continuation of the deterioration trend regarding minutes of non-supply from at least 2013. This is not according to the benefit presented by which from 2020, a decrease in the non-supply time is expected. The number of minutes of non-supply in 2021 was 136, i.e., an increase of 37.5% compared to 2017. Therefore, three years after the reform implementation and despite the increased investments in the network, there has been no improvement in the supply reliability, opposed to the Budget Division's assumption specified in the reform documents.

-  **Monitoring the Reform** – it was found that the Committee for Monitoring Financial Soundness, led by the Director of the Government Companies Authority, and the Committee for Monitoring the Implementation of the Reform, led by the Director General of the Ministry of Energy and the Director General of the Ministry of Finance established by the government are not convening as required. The Committee for Monitoring Financial Soundness convened once in 2019, and the Committee for Monitoring the Implementation of the Reform did not convene at all.

-  **The Number of Temporary Workers in the IEC** – in 2022–2024, the number of temporary workers at the Company will exceed the number set in the reform. It will be higher by 547, 458, and 82, respectively, compared to the goals set in the reform. Their employment cost is estimated at NIS 271.7 million. This addition of temporary workers reduces the expected benefits from the reduction of the Company's manpower in the reform. The approvals that the Company has received thus far to increase the quota of temporary workers will result in non-compliance with the efficiency goals of the Company's workforce under the reform.

-  **Salary Costs at the IEC** – the IEC salary expenses out of its total expenditures in 2021 (about NIS 4.852 billion) were the same as in 2016 (the eve of the reform). Despite the employee retirement promotions at the IEC in 2015–2019, salary costs did not decrease in 2014–2020. Retiring the employees as part of the reform reduced the Company's total salary costs. However, the solution is only a short-term one since, in the long term, the salary costs in the IEC continue to rise due to the Company's salary agreements.

-  **Salary Structure at the IEC** – about half of IEC employees receive a high salary (over NIS 30,000 per month) or are defined as officials⁴ (41% high-paid employees and 9% officials) compared to 23% of Mekorot employees, 18% of Israel Aerospace Industries employees and 11% of the Israel Railways employees, who are highly paid employees or officials. It was raised that the IEC has not yet signed a salary agreement regulating the change in the Company's salary structure, even though two years have passed since

⁴ In accordance with the definition in the Salary Commissioner's report.



the planned signing date (December 2019). Furthermore, the IEC did not complete the adoption of current models to incentivize employees (incentive pay), even though the remaining employees in the Company received significant compensation of about NIS 3.4 billion for the reform implementation.

- 👎 The Electricity Supply Reliability Problem in the Tel Aviv Metropolitan Area** – the Reading Station, supposed to be closed in January 2021, will continue to operate until at least 2026⁵ to prevent expected harm to the reliability of electricity supply to the Tel Aviv Metropolitan Area. This is despite being an old production station with low energy efficiency. Old units at the Eshkol Power Station, whose emission permits are expected to expire in September 2023, must continue operating to maintain the supply's reliability and the system's survivability in the Tel Aviv Metropolitan Area.
- 👎 Various Efficiency Measures Taken by the IEC Since 2018** – the efficiency measures taken by the IEC, including the reduction of manpower, the sale of power stations, and the reduction of financial debt and its costs, did not lead to a real improvement in the Company's efficiency and IEC's operating costs remained high, at about NIS 4 billion in 2021. In addition, the costs per unit of output in the production and distribution segments increased in 2018–2021 (by approximately 10.4% in the production segment and 3.3% in the distribution segment). According to the Company's forecasts, no significant improvement in its profitability is expected in the coming years either.
- 👎 Waiting Time on the 103 Hotline** – the Company failed to meet the target of the average waiting time on the 103 hotlines in each of the years 2015–2019. The target set for each of the years 2015–2018 was 90 seconds, and the target for 2019 was 180 seconds. The average performance was between 194 seconds and 269 seconds in these years. It was also found that during this period, there was a significant reduction in the targets from 90 seconds in 2015–2018 to 180 seconds in 2019. In 2020, this index was replaced by the index of compliance with the six-minute law, and the waiting time measure was not considered for assessing the department, division, and the company's score. Furthermore, there was a deterioration in the waiting times on the 103 hotlines, which increased by about 159% in 2012–2019 from 104 seconds to 269 seconds.

⁵ In Government Resolution 211 of August 1, 2021 regarding "Electricity Supply to the Tel Aviv Metropolitan Area" it was decided to continue operating the Reading Station temporarily. In December 2021, the National Planning and Building Council approved its continued operation until January 2026, and in addition ordered the preparation of a national outline plan that would allow the continued operation of the station beyond that, until 2030, with the possibility of an extension for another two years.






Implementation of the Reform Measures by the IEC – in 2018–2021, the IEC implemented the various measures stipulated in the reform, including reducing the number of permanent employees, reducing its share in the production segment by selling power stations according to the planned schedule, and taking internal efficiency measures.

The IEC Permanent Employees Workforce – in 2018–2021, 1,229 permanent employees retired. I.e., the IEC has met the reform goals of reducing the number of permanent employees in the Company, and even beyond that, by bringing forward the retirement of some of the employees.

Improvement of the IEC's Financial Position – in recent years, there has been a real and continuous improvement in the IEC's financial situation, reflected, among other things, in the reduction of its debt balance, a decrease in its costs and the improvement of financial indices. In May 2022, the Company's credit rating increased to BBB+.

Key Recommendations

-  It is recommended that the Minister of Energy and Finance, the Committee for Monitoring Financial Soundness of the IEC, and the Committee for Monitoring the Implementation of the Reform monitor the progress of the reform implementation and the streamlining of the Company and consider additional ways to streamline the Company and the electricity sector. Furthermore, the Ministry of Energy and Finance, the Government Companies Authority, the Salary Commissioner, and the Electricity Authority should analyze the reform results and conclude for the benefit of future reforms in the electricity sector and in general.
-  After three years from the reform adoption date and the beginning of its implementation, and given the differences between the benefits estimates presented to the decision makers and those that were realized, it is recommended that the Ministry of Finance (the Budget Division), of Energy and the Electricity Authority, examine the expected benefits of the set measures and present to the government changes to the various set goals, and accordingly present the IEC with efficiency goals that are compatible with the reform goals, to the extent necessary.
-  It is recommended that the Ministry of Energy, the Government Companies Authority, and IEC examine the Company's temporary employees' workforce with its tasks and the reform goals and find sources to finance the manpower increase and meet the reform goals. The parties (the IEC, its employees, and the Salary Commissioner) should complete formulating the new salary agreement, emphasizing efficiency, especially in the salary, and adapting the salary structure to developments in the labor market and the energy sector.



- 💡 The IEC should examine the reasons for the failure to decrease the expected operating costs and improve its operating indices.
- 💡 It is recommended that the IEC formulate effective indices examining the efficiency of its activities, particularly in customer service, throughout the Company and over time, and it is also recommended to minimize frequent changes in indices and goals to improve the comparability and effectiveness of the measurement. If the Company changes its goals and manner of calculation, it should also present this data for previous years to examine its performance over time. It is also recommended to present the reasons for changing the goals.

Efficiency Indices in IEC, 2015, 2018, and 2020

	2015	2018	2020
Financial stability			
EBITDA (in NIS millions)	7,152	7,959	7,525
Debt (in NIS millions)	44,580	38,337	30,013
Operation			
Operating cost of the production system per megawatt (in NIS thousands)	145	144	146
Transmission operating cost (in NIS per kilowatt)		16.54	15.5
Operating cost per customer in the distribution segment (in NIS per customer)	307 (2017)	340.6	377.1
Natural Gas cost (in USD per MMBTU)	5.69	6.09	5.33
Development			
Investments in the network (in NIS billions)	1.9	2.4	3.37
Minutes of non-supply	200	173.6	204
Manpower			
Permanent employees The reform goal for 2020: 7,411 permanent employees	9,277	8,206	7,403



	2015	2018	2020
Temporary employees The reform goal: 2,600–2,900 temporary employees	2,263	2,738	3,203
Total employees The reform goal: 10,800 employees	12,371	11,476	11,483
Salary expenses in NIS millions (at 2020 prices)	4,934 (4,978)	4,886 (4,872)	4,994
Average salary cost per employee in NIS per year (at 2020 prices)	401,746 (405,303)	423,928 (422,682)	430,980
Service			
The number of complaints from IEC customers	15,105	18,257	22,695
The number of complaints concerning service	774	689	2,047

Legend: ■ Deterioration in the efficiency index.

■ Index unchanged.

■ Improvement in the index.

According to various data from IEC, processed by the State Comptroller's Office.



Summary

In 2018, the government adopted a structural reform in the electricity sector and at the Israel Electric Company, among other things, to optimize the electricity sector, encourage competition, and strengthen the IEC's financial stability.

Three years after the signing of the reform, the IEC is working to achieve the various goals set in the reform. The findings of this report indicate that the IEC is implementing various reform efficiency measures, including reducing the number of permanent employees, selling power stations according to the set schedules, and taking internal efficiency measures. However, these measures as a whole do not lead to the required improvement in the Company's efficiency in particular and the efficiency of the electricity sector in general, and further steps are necessary to streamline the Company and the electricity sector.



Report of the State Comptroller of Israel |
November 2022

Israel Electric Company Ltd.

Preservation and Conversion of Coal- Fired Power Plants



Preservation and Conversion of Coal-Fired Power Plants

Background

In recent years, the Israeli government and the Ministry of Energy have decided to reduce the use of coal for electricity production, among other things, to reduce the air pollution emitted and to meet government goals following international agreements to reduce greenhouse gas emissions. Ten coal-fired power units operate in the electricity sector, all owned and operated by the Israel Electric Company Ltd. (IEC). In 2019, the Minister of Energy decided to convert six coal-fired units, where devices to reduce emissions (scrubbers) were installed, to natural gas-fired power plant. In 2021, the Minister of Energy decided to preserve four coal-fired units, in which no scrubbers were installed, as market insurance for an emergency year, this after the cessation of their current operations in 2022, depending on the fulfillment of the conditions¹ defined in Government Resolution 4080.

1 Government Resolution 4080 resolved to cease the current operations of units 1–4 at the Orot Rabin Station no later than June 1, 2022, provided that the following conditions are met cumulatively by the said date: (a) There will be a surplus in the supply of natural gas to the market in Israel through the connection of three natural gas reservoirs, each of which will be connected to the national natural gas transmission system via a separate infrastructure; (b) Start of operation of the first combined cycle power plant with a capacity of about 600 megawatts which will be established at the Orot Rabin Station by June 1, 2022.



Key Figures

10 coal units

six of which are to undergo conversion to natural gas, and four of which are to enter preservation in 2022

35%

the decreased rate of electricity production using coal from 2015 to 2020 due, among other things, to the Ministry of Energy's reduction policy

NIS 1.4 billion

the net excess cost (in present values) of the preservation project according to Electricity Authority. Including external costs of the project, this cost increased to NIS 2.7 billion, and it may rise to NIS 4.3 billion costs if increased periodic operations and lower scrapping costs would be included

NIS 124 million

the annual cost (in present values) of the preservation project, including operating, employee costs, fuel and air pollution damage costs

1,440 MW

the capacity of units 1–4 at the Orot Rabin plant, operating without scrubbers, that are to enter preservation in 2022

3,400 MW

the capacity of six coal-fired units that are to be converted to gas in 2022–2026

NIS 1.3 billion


the net excess cost (in present values) of the conversion project of the coal units with installed scrubbers

NIS 1.6 billion




the possible savings (in present values) from the seasonal operation of the converted units until 2045



Audit Actions





-  From March to December 2021, the State Comptroller's Office examined the Ministry of Energy's decision-making process to preserve and converge coal-fired power plants to natural gas, the calculations performed, and the alternatives considered as the basis of these decisions. The audit was conducted at the Ministry of Energy, the Electricity Authority (the Authority), the IEC, and the Ministry of Environmental Protection. Completion examinations were conducted at Noga – the Israel Independent System Operator Ltd. company.

Key Findings

-  **The Uniqueness of the Preservation of Units' 1–4 Project** – the preservation of coal-fired power units in the IEC outline has not been attempted in any other country. Most of the countries reviewed by the Authority are scrapping the coal-fired plants, and countries with low energy security continue to operate them.
-  **Estimates of the Scrapping Cost of Units 1–4 in the Preservation Document** – despite the adjustments made by the Authority to IEC's scrapping cost estimate (which reduced the scrapping cost estimate from NIS 687 million to NIS 506 million), the scrapping cost noted in the preservation document is twice the corresponding costs in the Authority's review. The Authority's review presents a lower scrapping cost of NIS 200 to 270 million. (instead of the scrapping cost considered in the amount of NIS 506 million) This increases the preservation project alternative excess costs by about NIS 66 to 85 million (an increase of about 5% to 6% of the excess cost of the preservation project). Additionally, presenting scrapping costs higher than those accepted worldwide increases the cost estimate of the scrapping alternative and the viability of the preservation alternative.
-  **The Potential Deviation of the Cost of the Preservation Project due to Periodic Activations** – between the preservation draft and the preservation document, IEC updated its assessment regarding the number and duration of the periodic activations required for the preservation of the units. According to the State Comptroller's Office estimate, this update is estimated at NIS 1.5 billion. It was found that the Electricity Authority presented the excess costs of the preservation alternative at about NIS 631 million according to the Company's minimal estimate regarding the periodic operations as included in the last preservation document. Presenting minimal costs may cause underestimated actual preservation project excess cost, in particular, given the






considerable uncertainty in the preservation project, due, among other things, to the lack of international and Company experience in similar projects and as an accurate assessment of the periodic activations will only be possible after an actual examination of the preservation outline.

-  **Updating the External Costs of the Preservation of Units 1–4 in an Emergency Year** – the Authority did not update in the preservation document the external costs of the damage of local pollutant emissions and greenhouse gases in an emergency year, and did not include the external costs from the damage of greenhouse gas emissions in the total preservation project excess cost. This bias in favor of the preservation project indicates benefit from the preservation alternative in an emergency year, but in practice, this alternative resulted in excess cost after updating the cost values. The failure to update the aforementioned external costs resulted in an underestimation of the preservation project, at NIS 709 million, and the exclusion of the external costs of greenhouse gases resulted in a devaluation of NIS 522 million, and in total, the excess cost of the preservation project in an emergency year was underestimated by about NIS 1.2 billion.
-  **Priority for Emergency Power Generation from Units 70–80 over Units 1–4** – supplying electricity from units 70–80 and units 1–4 at the Orot Rabin Station simultaneously is impossible, and therefore there is substitution option between units 70–80 powered by diesel fuel and units 1–4 powered by coal. The difficulty in transporting diesel fuel for electricity during an emergency emphasizes this substitutability because as long as it is not possible to transfer diesel fuel to sites other than the Orot Rabin plant – which has both primary diesel fuel reserve and a diesel fueling infrastructure – this reserve will most likely be used to generate electricity using units 70–80. Therefore, preserving units 1–4 for emergencies will not increase electricity generation at the economic level since units 70–80 are new and more efficient than units 1–4, at which case there is a priority in operating them over units 1–4.
-  **The Feasibility of Using Units 1–4 as a Response to Electricity Shortage During an Emergency** – given the preservation of units 1–4 is not carried out simultaneously, and its completion coincides with most of the period of the emergency event defined in the reference scenario, and given the difference between the Company's estimates regarding the preservation time, the ability to use units 1–4 during an emergency is uncertain. In case the emergency event materializes in a later year, the uncertainty regarding the ability to return from preservation will increase since the lack of continuous operation of the units regularly will reduce the units' serviceability and require more significant maintenance.
-  **Joint Personnel for the Operation of Units 1–4 and 70–80** – the reliance on joint personnel for the operation of units 70–80 and 1–4, and the need to divert workers from units 70–80 to 1–4 for their return from preservation, may affect the regular operation of units 70–80 during an emergency and the electricity supply from these units



until the return of units 1–4 to regular and continuous operation. The diversion of workers from units 70–80 to the preserved units 1–4 and its implications may increase the cost estimate of the preservation project.

-  **The Uncertainty in Preserved Units 1–4** – the differences between the preservation document from 2016 and the one from 2020 and the change in the Company preservation plan raise doubts over the ability to preserve units 1–4. The new IEC preservation plan in 2020 was not based on technological progress over time, and it is similar to the model of shutting down the units for maintenance for a few months and bringing them back into operation, as is done from time to time. Furthermore, although the preservation project is to ensure coal production capacity as a backup for natural gas in an emergency year, by the Authority and Company's preservation documents, there are no preservation projects in the current outline. The Company has no experience preserving coal-fired power plants for quick operation in an emergency. Moreover, the preservation project is complex and fraught with risks, among other things, as units 1–4 are old and require much maintenance. This may impair the ability to rely on continuous and reliable electricity production from these units during an emergency.
-  **Considering the Electricity Demand Decrease in an Emergency Year for Calculating the Damage Estimate to the Economy from Scrapping Units 1–4** – the IEC estimate of the expected damage to the economy in an emergency year due to the scrapping of units 1–4 in NIS 20 billion did consider the research literature and experience of changes in electricity demand during times of crisis. By the State Comptroller's Office calculation, given the electricity demand behavior in past events and according to the research literature, in the emergency scenario on which the Authority based the preservation document, and on which the IEC formed its opinion and estimated the extent of the unsupplied energy for the emergency year without the preservation of units 1–4, the decrease in emergency demand, which may reach up to 11%, was not considered.
-  **The Operating Regime of the Converted Units** – the efficiency of the coal-fired units, both before and after the conversion, is low relatively to the natural gas production units in the electricity sector. According to IEC estimates, the efficiency of the converted units will be about 38%, compared to the average efficiency of existing gas production units, which is about 46%. Due to operational constraints, the coal-fired units must work at a minimal load, i.e., an operating regime called Must Run. Given the efficiency of the converted units is low compared to the market average, and therefore they are more polluting and more expensive, so if preservation takes a short time, it will be possible to have a seasonal operation of the converted units saving both air pollution costs and fuel costs. Seasonal operation of the converted units from 2026 and up to 2045 (according to a conservative assumption that their operation will not be required for four months each year) may save about NIS 1.1 billion in fuel costs and external costs from emitting local pollutants. In addition, seasonal operation of the converted units may save an additional external cost regarding greenhouse gas emissions of about NIS half a billion.







Therefore, seasonal operation of the converted units from 2026 to 2045 may save costs in about NIS 1.6 billion (present value for 2019).





The Economic Viability of the Alternative of Converting Coal Units to Natural Gas – it was found that the investment required in the conversion alternative (about NIS 1.2 billion) is relatively low from the cost of establishing new capacity (a difference of about NIS 7.5 billion). It was also found that the cost of fuel in the conversion alternative (about NIS 2 billion) is higher than the cost of fuel in the preservation and establishment alternative (savings of about NIS 3.3 billion compared to the base alternative), or in the scrapping and establishment alternative (savings of about NIS 3.4 billion compared to the base alternative), due to the low efficiency of the converted units. However, this difference (for NIS 5.4 billion) is lower than the difference in the required investment cost, and therefore there is economic viability for the conversion project.

Key Recommendations

-  It is recommended that the Ministry of Energy and the Authority examine annually the need to preserve units 1–4 and the feasibility of their continued preservation, and scrap them according to the feasibility examination, subject to maintaining the guarantee of power supply during routine and emergency times and promoting the alternatives for generating power in these units as soon as possible.
-  Given the difference between the IEC scrapping cost and the actual costs in the United States it is recommended (a difference of NIS 417–487 million), that the Authority examine the cost structure of the preservation project and include them in the cost control of the project. It is further recommended that the Authority examine the costs derived from the first actual operation of the preserved units 1–4 and update its calculations, and present it jointly with Ministry of energy to the minister of Energy.
-  It is recommended that IEC and the Authority examine the number of workers needed to preserve units 1–4 without affecting the competency of units 70–80, calculate their cost and include it in the preservation costs. It is also recommended to examine the outline of the preserved 1–4 units while emphasizing the use of joint personnel from units 70–80 and 5–6 and considering the uncertainty regarding the timing and duration of return from preservation in an emergency.
-  It is recommended that the Ministry of Energy, the Authority, and the IEC examine the preservation project and its implications, given its excess costs, inherent risks, and existing alternatives, such as diesel generation in units 70–80 at the Orot Rabin plant.

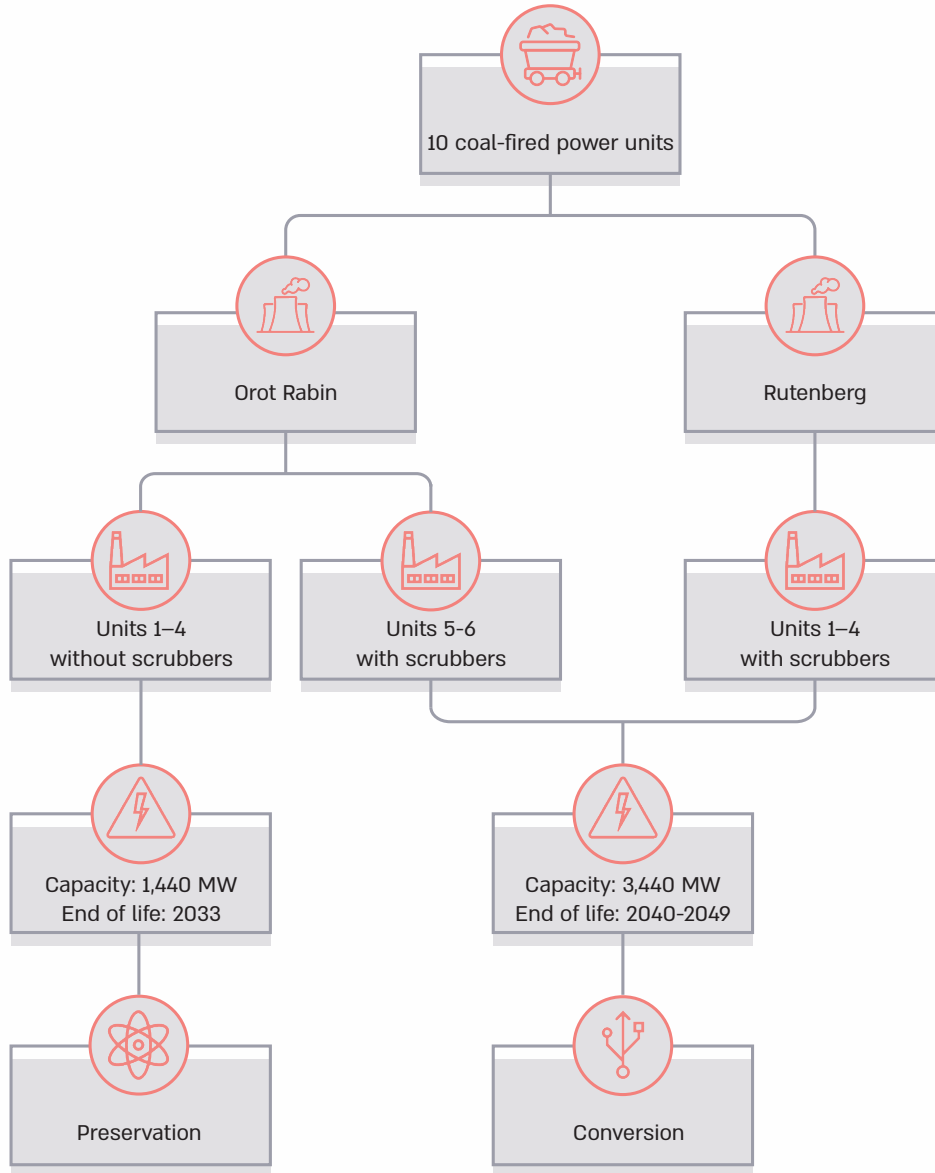


-  Given the potential savings in fuel costs and external costs from air pollution, and according to the difference between the capital cost of preserving units 1–4 for 12 years, at about NIS 162 million according to the IEC estimate, this compared to possible savings from seasonal operation in about NIS 1.6 billion (for approximately 20 years), considering the need to minimize costs under Section 1 of the Electricity Sector Law, 1996, it is recommended that the Authority and the Israel Independent System Operator company perform a cost-benefit analysis of the seasonal operation of the converted units and accordingly consider the possibility of seasonal operation of the converted units instead of continuous operation in the Must Run regime, considering operational constraints and the forecasted electricity demand.

-  Alongside the selection of the conversion alternative currently, it is recommended that the Authority and the Ministry of Energy examine over the years the technological developments in energy storage and remove the barriers to increase production through renewable energies and promote technological solutions enabling production with renewable energies with a smaller backup of fossil fuels and accordingly examine the need to continue implementing the conversion alternative.



The Characteristics and Purpose of the Coal-Fire Powered Units in the Electricity Sector



According to the Electricity Authority data processed by the State Comptroller's Office.



Summary

In recent years, the Israeli government and the Ministry of Energy policy have been to reduce the use of coal for electricity generation, among other things, to reduce air pollution and greenhouse gas emissions. The Minister of Energy's decision to preserve units 1–4 as emergency market insurance involves an excess cost that may reach up to NIS 4.3 billion. However, the inherent risks and the uncertainty regarding the return to use of the preserved units raise doubts over the project's ability to provide market insurance. This project also constitutes a complete alternative for electricity production in the new, efficient, and less polluting units 70–80, and in an emergency, the production in units 1–4 will be at their expense. Alongside the preservation project, the Minister of Energy decided to convert the coal units (those not intended for preservation). This project has economic viability and serves as the best alternative to stop the use of coal, as long as technological limitations require backup capacity with conventional installed capacity for electricity generation with renewable energies. However, there is a potential for substantial savings from the seasonal operation of the converted units instead of permanent operation at minimal load (Must Run).



Report of the State Comptroller of Israel |
November 2022

Energy Infrastructures Ltd.

Energy Infrastructures Ltd. – Financial Audit



Energy Infrastructures Ltd. – Financial Audit

Background

Fuel products are essential for the regular operation of the entire economy, and they currently play a central role in the development of the economy and its financial growth. Energy Infrastructures Ltd. (EI or the Company)¹ is a government company wholly owned by the state providing fuel for industry needs, including storage, flow, and supply of fuel products. EI subsidiary is Oil Products Pipeline Ltd. (the OPP Company), founded in 1959 and received the rights and assets of the Iraqi Oil Company. The Iraqi Oil Company received a 70-year concession from the British mandate, and the State of Israel recognized this concession. The concession expired at the beginning of 2001 and from then until June 2022, the state and the Company did not sign an operating agreement defining the assets that will remain in the Company, the assets that will be returned to the state, the taxation arrangements, the royalty payment arrangements (User Fees), the land ownership arrangements and other issues essential for the continuation of the Company's activities.


¹ This name was adopted in 2021. The Company's previous name – Energy and Oil Infrastructures (EOI).



Key Figures





800 km	NIS 1.37 billion	NIS 0	15%
the length of the pipe for the flow of crude fuel and fuel distillates	the distributable surplus balance and funds of the Company's as of December 31, 2020	the dividends the Company transferred to the state in 2017–2021	the net profit rate on average in 2018–2020 compared to a net profit of 2% on average in those years in international companies in the industry in which the Company operates
NIS 350 million	NIS 316 million	NIS 216–659 million	20 years
raised through the issuance of bonds from the institutional bodies to finance the functional continuity plan in 2020	EI's annual turnover in 2020	estimate of the harm to the economy from the failure to sign an operating agreement	since the Company's concession expired, however, the Company and the state have yet to sign an operating agreement

Audit Actions

 From August 2021 to January 2022, the State Comptroller's Office examined the Company's financial situation. The audit focused on the Company's financial statements for 2018–2020; the operating segments; the financial and economic ratios; material items from the balance sheet and the profit and loss statement; the auditing accountant work; and corporate governance issues. The audit was carried out at EI, the Ministry of Energy, and the Government Companies Authority. Supplementary examinations were carried out at the Haifa Municipality, the Shipping and Ports Authority at the Ministry of Transportation and Road Safety, the Israel Lands Authority (ILA), the Ministry of Environmental Protection, the Accountant General's Division at the Ministry of Finance and the Planning Administration at the Ministry of the Interior.



Key Findings

-  **Net Profit and Return on Assets According to Operating Segments** – it was raised that the gross profit in the storage and distribution of distillates segment increased in 2020 by 35% compared to the three years preceding it. In contrast, the gross profit in the piping, port services, and crude oil storage segments decreased in 2020 by 62% compared to the three years preceding it. Moreover, the rate of return on assets in the crude oil storage segment was on a downward trend – from 18% in 2017 to 8% in 2021. And the rate of return on assets in the port segment (5% on average) was lower than in the other segments (10% on average) in these years.
-  **Operating Agreement with the State** – since the Company's concession ended in January 2001, over 20 years ago, the Company and the state have not signed an operating agreement. This affects the Company's future operations planning and the state's income from the Company. Had an operating agreement been signed according to the agreements from 2003, it would have significantly impacted several key items in the financial statements, such as the state user fees from the Company's active assets, the rental of income-generating assets, and the tax assessment. By the State Comptroller's Office estimate, the lack of an operating agreement resulted in an economic loss (losses to the state and the Company) of NIS 216–659 million.
-  **Return of Assets to the State** – upon the end of the concession, the Company did not return to the state the assets that are not at the core of its activity, including half of a commercial building in Tirat Ha'Carmel, storage areas in the Atarot industrial area in Jerusalem and an area of 24 thousand sqm. in Shemen Beach in Haifa Bay. At the audit completion, the Company owned and operated these assets, and in 2020 they generated an annual income of NIS 1.6 million. It was raised that there are areas in the non-operating assets that were not rented and did not generate income, for example, the Company's land in Shemen Beach. Failure to transfer the state land assets not at the core of the Company's activity, as stipulated in the memorandum of understanding², caused a loss of income to the state and the Company due to the non-exhaustion of the revenue from those assets.
-  **Dividend Distribution to the State** – according to the Company's audited financial statements, at the end of 2020, from an accounting point of view, over NIS 1 billion were eligible for distribution as a dividend (from the balance of the accumulated profits and the funds). The Company's equity ratio of the total balance sheet at the end of 2020 was 64%. However, it increased because the Company did not regularly distribute dividends

2 The company and the government signed a memorandum of understanding in 2003 but never signed a formal operating agreement.



to the state. For example, from profits of NIS 214 million accumulated in 2017–2020, the Company did not transfer any dividends to the state, even though the Government Companies Authority decided in January 2019 that it must distribute dividends (50% of the net profit). The undistributed dividends for 2017–2020 were NIS 107 million.

Net Profit Rate – the Company's average net profit rate in 2017–2020 (15%) was considerably higher than the profit rate of four leading companies in the same sector in the United States (2%) and is similar to the profit rate of the Israel Natural Gas Lines Company. The external capital rate of the Company (36% in 2020) is low and conservative compared to the other government companies sampled (average of 75%) and compared to the target set by the Government Companies Authority for 2021 (45%).

Administrative and General Expenses – the rate of administrative and general expenses from the Company's revenues in 2018–2020 (13%) was over the rate set by the Price Committee – Energy (about 9%). It should be noted that the Company's expenditure (NIS 45 million) is about NIS 17 million more than the expenditure calculated by the norm set by the Price Committee – Energy (NIS 28 million, which is 9% of the revenues of NIS 316 million).


The Company's Assets and the Assets it Operates

- **The Kiryat Haim Tank Farm ("The Terminal")** – in April 2022, the Kiryat Haim Tank Farm had 42 fuel tanks. 22 of them (about half), a third of the total storage capacity at the site, were unusable. Therefore, the use of the tank farm premises is only partial. The fuel storage infrastructure is old, and in 2017–2021, the Company invested about NIS 187 million in the maintenance of the tanks.
- **Land Owned by the Company in Haifa Bay – The Northern Lands** – for decades, an area of 1,147 thousand sqm. owned by the Company in Haifa Bay (the northern lands) has not been generating any value for the state and the Company; The financial statements have no information on the value of the lands and the state's share in these lands.
- **The Fuel Port in Haifa** – the fuel port in Haifa is outdated and does not meet modern construction standards. However, disagreements between the decision makers affix the situation of the continued operation of the old fuel port, and the plan to renovate it has not been implemented.
- **Registration of Land Rights** – by data provided by ILA and the Company to the State Comptroller's Office, the use of 8 out of 12 properties at the core of the Company's activity is not regulated by ILA.

The Company's Tariff – to calculate the Company's tariff, the Price Control Committee considers the Company's weighted return (WACC). The components that must be considered are the risk-free interest rate for determining equity; the risk-free interest



rate for foreign capital; the market interest rate; and the sector adjustment coefficient rate (beta). The only updated variable during the annual price update was the risk-free interest rate for determining equity. It was found that the calculation resulted in setting the return at 4.59%. On the other hand, if the Committee had considered all of EI's components in calculating the weighted cost of capital, the return would have been at a rate of 3.93%. Given the equity in the balance sheet of NIS 1,371 million as of December 31, 2020, this would have affected the tariff and would have reduced the Company's revenues by about NIS 9 million, i.e., a price drop of about 2.5% of its revenues in 2019 (the last reported year without the effects of Covid-19 pandemic).

 **The Term of Office of the Auditor** – as of the audit completion date, January 2022, the Ministers of Finance and Justice and the Government Companies Authority did not appoint the committee members for appointing accountants. As a result, the Company's auditor has been serving for about 18 years, 12 years over the period stipulated in the rules of the Government Companies Authority.

 **The Board of Directors of the Company and the Subsidiary (OPP):**


- **Adequate Representation** – it was raised that in December 2021, six of the eight directors in office in EI were men.
- **OPP's Board of Directors** – it was raised that in 2017–2020 there was no legal quorum for the OPP board of directors, and at the audit completion – January 2022, there was only one director.



The Company's Rating – in February 2020, the Company was given an initial conditional rating by the "Midroog" credit rating company, the highest possible rating – Aaa. il. In March 2022, a follow-up report was published, and the rating horizon of bonds issued by the Company that year was determined to be stable.





Corporate Governance – the State Comptroller's Office commends the Company for compliance with the ISO 37001 standard for the anti-bribery system, developing and implementing a code of ethics, and operating an effective risk assessment system.

Key Recommendations

 The Ministry of Finance, under the leadership of the Accountant General, the Government Companies Authority, the Ministry of Energy, ILA, and the Tax Authority, should complete the formulation of an agreed operating agreement with the Company. This is to regulate the payments of the land use fees, the income tax assessment, the transfer of the dividends and assets to the state, and to enable regulation of the Company's activities and its



development in the long term with a renewed license. This need for agreement intensifies as the Company intends to raise additional funds from the public through the issuance of bonds.

-  It is appropriate that the Government Companies Authority and the Ministry of Finance regulate the payments to the state for the use of active assets, including the settlement of past debts. ILA and the Company should arrange valid lease agreements regarding all of the Company's assets to ensure certainty of rights and obligations towards the state regarding the land and that the state receives lease fees and use fees for the land.
-  The Company should implement the board of directors' resolution from June 2021 to distribute dividends to the state at the rate set by the Government Companies Authority (50% of the net profit). It is recommended that the Government Companies Authority verify the Company's compliance with the dividend distribution targets set by the Government Companies Authority in an ongoing manner as part of the control over the Company's compliance with all of its goals.
-  The State Comptroller's Office recommends that the Company's board of directors and the Government Companies Authority examine the high rate of the Company's net profit over the years. It is further recommended that the Price Committee – Energy analyze the rates approved for the Company as a key player or monopoly in its core activity, affecting its revenues and profitability in its financial statements.
-  It is recommended that the Minister of Energy, the Minister of Finance, and the Government Companies Authority ensure adequate representation of women on the Company's board of directors. It is also recommended that the Minister of Energy and the Minister of Finance appoint directors to the OPP company so that it can duly adopt decisions.



The Company's Areas of Operation (Segments) in 2020 (in NIS Thousands)

	Storage and Distribution of Distillates	Piping	Port Services	Storage crude oil	Total
Revenues	147,913	81,991	52,246	33,476	315,626
The segment's share in the total revenues	47%	26%	17%	11%	100%
Total expenditure	97,422	62,190	47,498	26,719	233,830
The expenses rate from the revenues	66%	76%	91%	80%	74%
Gross profit	50,490	19,801	4,748	6,757	81,796
The gross profit rate from the revenues	34%	24%	9%	20%	26%
The segment's assets	124,458	566,656	5,454	-	696,568
Mixed operating assets	222,104	117,269	198,145	169,567	707,085
Total assets attributed to the segment	346,562	683,925	203,599	169,567	1,403,653
The rate of profit from the segment's assets	15%	3%	2%	5%	6%
Assets not attributed to the segment					133,126
Total assets					1,536,779

Source: EI.



Summary

EI is a significant factor in the fuel industry in Israel in routine and in emergency and is a monopoly or a key player in most of its operating segments. The Company's facilities and pipelines are spread across the length and breadth of the country. The Company's net profit rate over the years is relatively high (10%–20%) and sound. However, its long-term financial situation is unclear since, in March 2022, the government decided to close down the petrochemical segment in the Haifa region. Such a decision has wide-ranging effects on the Company, including the relocation of infrastructure and the potential to affect its scope of activity. In addition, the Minister and the Ministry of Energy did not validate the Company's strategic plan.

The audit raised that the Company has been operating for more than 20 years without an operating agreement between it and the state regulating the relationship between them and the ownership of the assets that the Company maintains and operates. As a result, among other things, there was an economic loss (to the state and the Company) during this period estimated at hundreds of millions of NIS (from NIS 216 to 659 million). In addition, a dispute between the Company and the Tax Authority over tens of millions of NIS of the Company's tax liability regarding land assets that are supposed to be transferred to the state is being heard in court. It was also found that the Company has a surplus balance eligible for distribution as a dividend to the state of more than NIS 1 billion and that in 2017–2020 the Company did not distribute dividends to the state.

The Ministry of Finance, under the leadership of the Accountant General, the Ministry of Energy, the Government Companies Authority, the Tax Authority, and the ILA, with the assistance of the Attorney General, should formulate an agreed operating agreement with the Company. The Government Companies Authority should cooperate with the Company's board of directors to distribute dividends to the state.



Report of the State Comptroller of Israel |
November 2022

Ayalon Highways Ltd.

Ayalon Highways Ltd. – Reorganization and Financial Aspects



Ayalon Highways Ltd. – Reorganization and Financial Aspects

Background

Ayalon Highways Ltd. (AH or the Company) is a government company that serves mainly as an executive arm of the Ministry of Transportation and Road Safety (Ministry of Transportation or MOT). Until 2016, the Company was jointly owned by the Israeli government and the Tel Aviv-Jaffa municipality; That year, the Company became wholly owned by the state, and in 2018 the Company began a reorganization process. In 2017 and 2020, two government resolutions were adopted, redefining its goals and expanding its areas of operation. Among its goals: planning urban and metropolitan transportation projects and their execution; Creating and managing the transportation master plan team; Management, initiation, and development of technological projects in transportation; Planning, development, maintenance, and traffic management of roads and public transportation facilities. The MOT finances most projects the Company is responsible for and supervises its activities. The Government Companies Authority and the Ministry of Finance also monitor the Company's activities.



Key Figures





97%	NIS 1.296 billion	61%	NIS 7.6 billion
of the Company's revenues in 2021 were from the MOT	the company revenues in 2020; 94% of them from project management	the average annual growth rate of the Company's activity in 2017–2020	the order backlog at the end of 2020
5.7%	175	1.16	68%
the rate of administrative and general expenses in relation to the cost of sales. The target set for the Company by the Government Companies Authority: 4%	the Company's employees in 2020, compared to 71 in 2017	the current ratio in the 2020 balance sheet	of the Company's invoices paid to its suppliers and reviewed by the MOT in 2021 – about NIS 555 million, deviated from the Payment Ethics Law rules

Audit Actions

- From September 2021 to March 2022, the State Comptroller Office examined the Company's reorganization procedure, its financial data, its work processes regarding project management, and the Company's control processes. The financial data and quantitative information in the financial statements for 2020 included in the audit are correct as of the end of 2020 (unless otherwise stated in the body of the report). The audit was conducted at the AH and the Ministry of Transportation. Completion audits were conducted at the Government Companies Authority and the Ministry of Finance.








Key Findings

-  **Determining the Areas of Operation of the Government Infrastructure Companies by the MOT** – the audit raised that the Ministry of Transportation did not formulate a policy document based on systemic, strategic work indicating the advantages and disadvantages of the various dividing options of the operation areas between the infrastructure companies. Therefore, the government resolutions determined the goals of the infrastructure companies without a coherent strategy. In practice, the resolutions were based upon the situation that prevailed then, without guidelines for distributing the projects and works between the companies. The lack of a clear policy also causes uncertainty to the infrastructure companies and might make it difficult for them to plan their activity optimally.
-  **The Framework Agreement Between the State and the Company** – as of the audit completion – more than five years after the separation of the holdings in AH was completed, and since the government wholly owns the Company – no framework agreement has been signed between it and the government. Government resolutions stipulate that the Company's activities will be based on agreements signed between the state and the Company, anchoring various issues of the delivery of works, the Company's conduct vis-a-vis the government, and its supervision and control. However, during these years, the MOT handed over many assignments and projects to the Company without an agreement and an orderly procedure for engagement with a tender exemption, in contravention of the Mandatory Tenders Regulations.
-  **Appointment of Directors** – the audit found that for a year and a half (except for two months), the composition of the board of directors was lacking, according to the Company's statute, and consisted of two to four members instead of five to nine members as stipulated in the Company's statute. Moreover, the board meetings had no legal quorum for two months. As of the audit completion, the board of directors is operating with a wanting panel – with only four members – which may affect the Company's proper management.
-  **The Company's Responsibility and Powers** – promoting urban projects efficiently and minimizing the adverse affect on the city's day-to-day life require close coordination between AH and the local authorities. As the Company does not have the required powers to promote the projects, including the powers of a signage authority, the progress of the projects depends on the local authorities consent, whose interests sometimes do not coincide with the interests underlying the promotion of the projects. This is especially material when projects pass within the jurisdiction of several authorities, as in the "Fast to the City" (Mahir la'ir) Project. In some projects, due to their planning





complexity and the long time required to complete them, the local authorities changed their position and demanded changes in the planning.

-  **Metropolitan Transportation Authorities** – in the absence of metropolitan transportation authorities, the Company fulfills some of the roles that these authorities were supposed to fulfill, including establishing and operating metropolitan centers for traffic management and control. However, without regulation anchoring the powers of the body that manages the centers, AH should reach mutual agreements with each local authority separately. Thus, the operation of the metropolitan command and control center established in Tel Aviv-Yafo is delayed.
-  **The Company's Level of Liquidity** – by the analysis of the Company's financial statements, alongside the accelerated growth in the Company's activity, its level of liquidity is decreasing. The liquidity indices indicate that the Company's means to finance its activities are decreasing, and the importance of timing the receipt of funds from the MOT for payments to its suppliers and the Ministry's approval of the entire payments is increasing. It should be noted that according to the Company's risk survey, the Company rated its dependence on government decisions and regulatory factors as a high-level risk (ranking 5 out of 5) with a high degree of probability (ranking 4 out of 5).
-  **Claims Against the Company** – the Company's provisions for claims in the balance sheet at the end of 2020 were about NIS 3.7 million. At the same time, the scope of claims was NIS 594 million, for which no provision was made, most of them due to the decrease in the value of assets under Section 197 of the Planning and Building Law, 1965. By the company's notes in its financial statements, based on experience and its legal counsel's opinion, it has no financial exposure regarding claims for which it has not made a provision due to small chances assessment of the claims or due to their preliminary stages.
-  **The Company's Payment Ethics** – under the Payment Ethics Law, the Company should pay its suppliers in engagements other than construction engineering works within 30 or 45 days and in construction engineering works – within 70 or 85 days. 68% of the invoices paid by the Company to its suppliers and examined by the MOT in 2021, about NIS 555 million, deviated from the Payment Ethics Law. Furthermore, about 28% of the overdue payments were transferred to suppliers with a delay of over 50 days.
-  **Budgeting of Projects and Their Management** – in examining projects over NIS 30 million, it was found that the costs determined in the tender were 3% to 27% lower than the estimated contractual costs before the publication of the tender. This prevails in most of the AH projects examined in the audit (64 out of 69), particularly in the larger ones, although the audit also found the opposite. The budget allocated by the MOT for the project's execution is determined before the publication of the tender, according to the RFT report, and it is not updated afterward according to the cost specified in the tender. This allows the Company great flexibility with project changes, sometimes



resulting of complexity and great management uncertainty. However, the difference in costs may fund increased expenditure on the project, with little supervision and control, since the additional expense does not exceed the budget framework. In all the projects examined at over NIS 30 million, the contract works cost increased during the project execution compared to the cost stipulated in the contractor agreement.

-  **Project Management System** – it was found that the project information appears in the Company's various execution divisions. Still, no single information system contains all the project data and no uniform format for saving the information and generating reports.
-  **Controls on the Company by the Ministry of Transportation** – there is a shortage of employees in the Infrastructure Administration of the MOT, and four out of six positions are not staffed, which may affect the processes of supervision and control of government infrastructure companies, including AH. Deficiencies were found in the MOT controls of AH's compliance with the cash flow forecast, the projects' adherence to the budget and schedules, and the documentation of the changes in the budget and schedules. Moreover, MOT has no suitable computer system to efficiently monitor the project's progress, presenting the changes and their causes in the schedules, budget, and contents throughout its life and obtaining a comprehensive situation report on the budget transferred to the Company.










The Company's Reorganization – the Company began to reorganize in 2018. By the audit end, it had, among other things, made a fundamental change in the organizational structure, formulated and implemented a new system of procedures, significantly increased its workforce, implemented new computer systems, drew conclusions from previous audit reports, implemented control processes, conducted a risk survey, formulated a strategic plan and more. All this while significantly increasing the scope of activities and expanding and improving the Company's performance capacity.

Coordination with Other Infrastructure Companies and Government Bodies – the State Comptroller's Office commends the establishment of the infrastructure coordination system by the MOT, the Prime Minister's Office, and the Ministry of Finance to facilitate the locating of infrastructure for promoting transportation projects and the coordination request process. However, there are still many difficulties following the submission of coordination requests when determining the content of the works, the time of their execution, and the identity of those executing them and during the actual execution of the works. For example, delays in the coordination and execution of infrastructure relocation work carried out by other infrastructure companies and reduced working hours in the areas of the railways to reduce the harm to the train's activity.

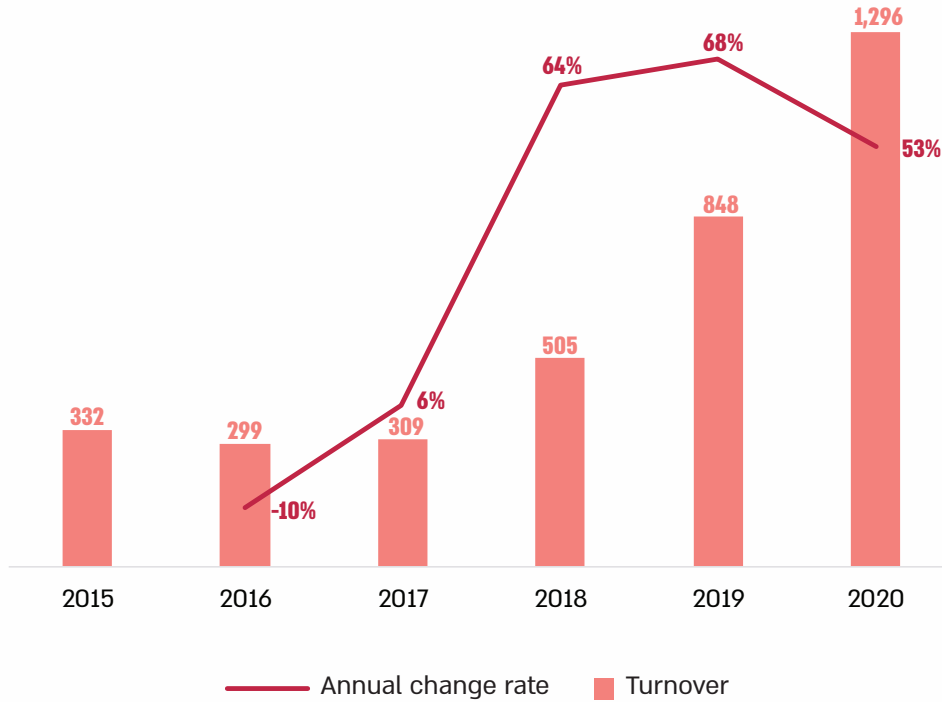


Key Recommendations

-  The MOT and AH, in coordination with the Government Companies Authority and the Ministry of Finance, should sign a framework agreement between the state and the Company to regulate the joint activity under the government's resolutions and the Mandatory Tenders Regulations.
-  The Ministers of Transportation and Finance should appoint directors under the Government Companies Law for the Company's proper corporate governance.
-  It is recommended that the Ministries of Transportation and Finance establish metropolitan transportation authorities and, until then, use alternatives as interim solutions to remove the barriers to the Company's activities and balance the metropolitan interests with the local ones.
-  It is recommended that the MOT continue to examine and implement ways to ease transportation infrastructure companies to enlist the cooperation required for engineering coordination and facilitate the work processes. For example, collaborating with relevant government bodies and regulators, and create a uniform version of the agreements, commitments, and insurance requirements.
-  The Company and the MOT should examine the reasons for deviation from the Payment Ethics Law, comply with the law's requirements, and fully cooperate in shortening the times for approving payments and their handling.
-  It is recommended that the MOT implement a comprehensive information system for managing projects in the transportation infrastructure companies in general and AH in particular and that the infrastructure companies cooperate with it. It is also recommended to consider integrating into the system an online module for reports to the MOT in a uniform format for all infrastructure companies.
-  It is recommended that the Ministry of Finance and the MOT adjust the commitments for the project's execution, considering the results of the tenders. It is also recommended to consider a mechanism for increasing expenditure beyond the contractual agreement. If so, it is recommended that the Ministry of Finance and the MOT implement a flexible and controlled mechanism to allocate the budget according to project risk level. For example, through the budgeting of contingencies, for which regular supervision and control mechanisms have been defined, or through the budgeting of a designated reserve.



AH's Turnover, 2015–2020 (in NIS millions)*



According to the Company's financial statements data, it is processed by the State Comptroller's Office.

* In the financial statements for 2018, the Company adopted the IFRS standards for the first time. The reporting date for the transition to this standard was January 1, 2017. Therefore, the numerical comparison of 2015 and 2016 to the following years is inaccurate. To counteract the effect of the change in the reporting method on the annual change rates, the change rates were calculated each year compared to the previous one based on the data in the same financial statement.



Summary

Since AH's reorganization began, there has been a considerable increase in its activities scope, its areas of activity have been expanded, and it has made substantial changes in its organizational structure and work methods. The audit raised that the regulation of the Company's activities vis-à-vis the state, particularly the MOT, has not been completed since it became a company wholly owned by the government. It was found that the Company has no project management system nor uniform format for information saving. In addition, deficiencies were found in the MOT controls. It was also found that the Company sometimes finds it difficult to cooperate with local authorities, other infrastructure companies, and government bodies for coordinating infrastructures. It is recommended that the Ministries of Transportation and Finance, and the Government Companies Authority regulate AH's activities and its powers and improve the monitoring, supervision, and control of its functioning. It is also recommended that the Company continue to develop its capabilities in the areas under its purview.



Report of the State Comptroller of Israel |
November 2022

Capital Market, Insurance, and
Savings Authority

Aspects of Cumulative Pensions and the Pension Distribution Market – Follow-up Audit



Aspects of Cumulative Pensions and the Pension Distribution Market – Follow-up Audit

Background

Savings for retirement age consists of three layers: the first layer is the old-age pension; the second layer, usually the primary source of income after retirement from work, is the pension savings accumulated by the employee throughout his years of work; and the third layer is the private savings of households. The new pension funds are included in the second layer of pension savings – as Defined Contribution (DC) pension plans. In the DC method, the benefit is determined according to the accumulation of the employee's and the employer's provisions to the fund, plus the return earned by the fund, net of the management fees, and based on assumptions regarding life expectancy. In this method, the return risks are entirely borne by the employee.



Key Figures

**NIS
464.7
billion**

the balance of assets of the new pension funds by December 31, 2020 – an increase of about 15% compared to 2019

**NIS
44.9
billion**

deposits to the new pension funds in 2020 – a 5% increase compared to 2019

1.95%

management fees average rate from the deposits of all members in the new and comprehensive pension funds in 2020, compared to 2.85% in 2016

0.19%

management fees average rate from the assets of all members in the new and comprehensive pension funds in 2020, compared to 0.26% in 2016

56%

the rate of inactive savers who paid the maximum management fees in 2021, compared to 90% in 2015

93%

the rate of pensioners who are recipients of an allowance who paid the maximum management fees in the five largest new pension funds in 2021, compared to 100% in 2015

41.5%—


43.2%

the cumulative return of the default funds, compared to an average return of 35.56% for all new pension funds in 2019–2021

479

the number of pension consultation license holders in 2020 – compared to 922 in 2015 – a decrease of about 48%

Audit Actions

 In 2016, the State Comptroller's Office published a special audit report regarding the pension arrangements in the country¹ (Previous Audit Report). From January to March 2022, the State Comptroller's Office examined the Capital Market, Insurance, and Savings Authority (Capital Market Authority) actions to rectify the deficiencies noted in the Previous Audit Report in the cumulative pension and the pension distribution market. The follow-up audit was conducted at the Capital Market Authority. Completion examinations were carried out in the following government ministries and companies: the Ministry of Economy and Industry, the Ministry of Energy, the Ministry of Education,

¹ The State Comptroller, Special Audit Report on the **Pension Arrangements in the Country** (2016).



the Ministry of Justice, the Ministry of Public Security, the Ministry of Interior, the Ministry of Communications, the Civil Service Commission, Haifa Port Company Ltd. (Haifa Port), Israel Electric Company Ltd. (the Electric Company), Ashdod Port Company Ltd. (Ashdod Port), Israel Railways Company Ltd. (Israel Railways) and Netivei Israel – National Transport Infrastructure Company Ltd. (Netivei Israel).

Key Findings



The Rate of Management Fees of Inactive Savers – the Previous Audit raised that about 90% of inactive savers in the five largest new pension funds paid the maximum management fees. The follow-up audit raised that the deficiency was partially rectified. In 2021, about 67% of inactive savers in the five largest new pension funds paid the maximum management fees, but the rate of inactive savers who paid the maximum management fees in the market as a whole in 2021 was about 56%.



The Ownership Structure in the Pension Distribution Market – by the Previous Audit, the Capital Market Authority did not examine the ownership structure of the insurance and arrangement agencies² and did not set provisions limiting the distribution of the parent company's products through agencies owned by institutional entities. By the follow-up audit, the deficiency was rectified to a small extent – the Capital Market Authority did examine the ownership structure of the insurance and arrangement agencies but did not set provisions limiting the distribution of the parent company's products through agencies owned by institutional entities.



The Agents' Compensation Model – by the Previous Audit, the Capital Market Authority did not set clear rules to provide economic incentives in the insurance agents' compensation method to minimize the influence of extraneous considerations regarding the distribution of the client pension savings. The follow-up audit raised that the deficiency was not rectified and that the rules above had not been set.





The Reasoning Document – section 14 of the Control of Financial Services (Pension Consulting, Marketing, and Clearing System) Law, 2005 (Pension Consulting and Marketing Law), requires the license holder to provide the client when recommending savings, a written document detailing the recommendation reasons regarding the profitability of the client's or their relative's savings using a pension product (the Reasoning Document). In the Previous Audit, the State Comptroller's Office found that


² Large agencies that specialize in managing complex pension arrangements for enterprises, including consulting for the employers and enterprise employees, accompanying the clients throughout their insurance life, collecting the funds each month and distributing the funds between the various companies and products.



the use of the Reasoning Document as a main working tool by the license holder created the appearance of concern for the client's best interests but, in practice, did not guarantee that the selected pension product was indeed the most appropriate product for the client, and therefore does not solve the inherent conflict of interest of the insurance agent. The follow-up audit found that the deficiency was slightly rectified – the Capital Market Authority changed the Reasoning Document and expanded the due diligence regarding the considerations that guided the license holder in the recommendation, but this does not solve the inherent conflict of interest of the insurance agent.

 **The Pension Consulting Market** – by the Previous Audit, the pension consultation licensees rate among all consultation and brokerage licensees services related to insurance products and pension savings³ was only about 9% in 2014. Concerning most of the population, there is a lack of objective pension consulting to consider the insured needs. The follow-up audit raised that the deficiency was not rectified: the number of pension consultation licensees decreased from 922 in 2015 to 479 in 2020 (a decrease of about 48%). Furthermore, there has been a decrease in the rate of pension consultation licensees out of all individual license holders in the pension distribution market – from 8.2% in 2015 to 4% in 2020.

 **The Effectiveness of Enforcement** – by the Previous Audit, no strategic examination work on the effectiveness of the enforcement of the provisions of the Pension Consulting and Marketing Law was conducted by the Capital Market Authority. By the follow-up audit, the deficiency was not rectified – the Authority did not carry out any strategic work to examine the effectiveness of the enforcement it performs, except for examinations of a few appeals it received from the public.

 **Frequency of Pension Consulting or Marketing During an Employee's Life** – in all the audited entities in the follow-up audit (except for Israel Railways), including government ministries, the Electric Company, Haifa Port, Ashdod Port, and Netivei Israel, the employees do not receive pension consultation during their employment period, when there may be changes in their personal or marital status. In some organizations, employees are referred to a pension insurance agent or a pension marketer, which may cause a possible bias in the insurance products that employees receive.



The Management Fee Rate for Pensioners – the Previous Audit raised that in 2015 all pensioners in the five largest new pension funds paid the maximum management fee rate set by law. The follow-up audit raised that regarding retirees who retired as of February 2022, the deficiency was fully rectified, but no solution was found regarding members who retired before that date. In January 2022, the Knesset Finance Committee

3 Including pension insurance agents, pension marketers and pension consultants.



approved the amendment⁴ to the Control of Financial Services Regulations (Provident Funds) (Management Fees), 2012. In the said amendment, which was initiated by the Capital Market, Insurance and Savings Authority Commissioner in cooperation with the Minister of Finance, a lower cap for management fees was set for pensioners at 0.3% (instead of 0.5% in a new comprehensive pension fund and 0.6% in a new general pension fund) compared to the cap set in the Regulations. The follow-up audit further raised that in 2021, before the said amendment, about 93% of the pensioners receiving the allowance in the five large new pension funds still paid the maximum management fees, and that the percentage of those paying the maximum management fees among retirees has decreased in recent years from 100% in 2017 to 68% in 2021. The excess payment of pensioners receiving allowances who paid the maximum management fees in 2021, compared to the average rate of management fees paid by all members that year, was about NIS 59–87 million.

Choice of Selected Funds by the Capital Market Authority – in the Previous Report, the State Comptroller's Office recommended that the Capital Market Authority reconsider, as part of the arrangement's impact on the pension market, the need for additional criteria for selecting the default funds⁵, other than the rate of management fees, such as product quality and the adjusted yield. The follow-up audit raised that the deficiency was fully rectified and that in the framework of the second and third procedures for determining selected funds, published in August 2018 and August 2021, respectively, the Capital Market Authority considered adding criteria for choosing a selected fund, apart from the proposed management fee rate, and decided it was best to leave the management fee criteria as the only criteria in the selection process. This is because the management fee criterion is the only objective criterion on which this procedure can be based.

Selection of a Default Fund by an Employer or an Employee Organization – the Previous Audit raised, regarding the competitive procedure to select a default fund by an employer or an employee organization, that the Capital Market Authority did not adjust the yield criteria to the risk level of the investment portfolio, which may result in an inadequate comparison between the funds in the competitive process. The follow-up audit raised that the deficiency was rectified to a large extent, and that as part of the third procedure, the Capital Market Authority decided that in a competitive procedure that includes a criterion of the provident fund's yield, it would be possible to add the criterion of the "Sharpe risk-free interest rate index"⁶, which expresses the risk of the investment portfolio, however the Authority did not mandate the addition of this criteria.

4 The Control of Financial Services Regulations (Provident Funds) (Management Fees) (Amendment), 2021. The regulations were approved in January 2022 and entered into force with respect to retirees who began to receive an old-age pension from February 1, 2022 onwards.






5 The term "default funds" was used in the Previous Report to describe funds selected in a tender process conducted by the Capital Market Authority to provide discounted management fees to new entrants. Over the years, the Authority changed the term to "selected funds", as detailed in the report.

6 An index estimating the fund's excess return beyond the risk-free interest rate. A high Sharpe Index indicates better performance, i.e. a higher return per standard deviation unit.



The Actuarial Deficit in the New Pension Funds Created by Recipients of Disability Allowance and Survivors' Pension – the Previous Audit raised that disability allowance and survivors' pension recipients created an actuarial deficit, which causes subsidizing between them and the other members of the fund. The follow-up audit raised that the deficiency was fully rectified – the Capital Market Authority settled the cross-subsidy problem between all members through a mechanism that transfers the risk to the pensioner himself and not to all fund members.

Key Recommendations

-  It is recommended that the Capital Market Authority continue to monitor the composition of the balances of the inactive savers who pay the maximum management fees and examine how to reduce the balance.
-  It is recommended that the Capital Market Authority establish clear rules for providing economic incentives in the compensation method of the insurance agents to minimize the influence of extraneous considerations regarding the distribution of pension savings to the client.
-  It is recommended that the Capital Market Authority examine the Reasoning Document and adapt it to the changing needs and technological developments in recent years. It is also recommended that the Authority consider additional ways and tools to handle conflicts of interest in the activities of insurance agents to minimize the influence of irrelevant and non-professional considerations on the activities of insurance agents vis-à-vis clients.
-  It is recommended that the Capital Market Authority develop and optimize the pension consulting market, promote regulation to enable the provision of pension consulting in a digital, advanced, and convenient manner, and examine the pricing model for pension consulting with an overall view of the profitability for all players in the market.
-  It is recommended that the Capital Market Authority examine ways to increase the frequency of pension consulting provided to employees, particularly at critical points in time, such as when starting work, when there are changes in the employee's personal or marital status, and when he retires. This is to ensure the adaptation of the pension insurance to the employee's needs and rights. In addition, it is recommended that the Civil Service Commission and the directors general of the various entities formulate a procedure for referring employees to pension consulting periodically.



Extent of Rectification of the Main Deficiencies Noted in the Previous Audit

The Audit Chapter	The Audit Chapter	The Deficiency noted in the Previous Audit Report	The Extent of Rectification of the Deficiency Noted in the Follow-up Audit				
			Not Rectified	Slightly Rectified	Partially Rectified	Considerably Rectified	Completely Rectified
Cumulative pension	The Capital Market Authority	Most inactive savers paid the maximum management fees.					
Cumulative pension	The Capital Market Authority	All pensioners paid the maximum management fees set in by law.					
Cumulative pension	The Capital Market Authority	Examining the use of a single criterion of management fees in determining a default fund.					
Cumulative pension	The Capital Market Authority	Failure to adjust the yield criterion in the competitive process to select a default fund by an employer or employee organization to the risk level of the portfolio.					
Cumulative pension	The Capital Market Authority	Recipients of disability allowance and survivor's pension create an actuarial deficit causing subsidization between them and the other members of the fund.					



The Audit Chapter	The Audit Chapter	The Deficiency noted in the Previous Audit Report	The Extent of Rectification of the Deficiency Noted in the Follow-up Audit				
			Not Rectified	Slightly Rectified	Partially Rectified	Considerably Rectified	Completely Rectified
The Pension Distribution Market	The Capital Market Authority	Failure to examine the ownership structure of insurance and arrangement agencies.					
The Pension Distribution Market	The Capital Market Authority	Failure to regulate clear rules for providing economic incentives in the insurance agents' compensation method.					
The Pension Distribution Market	The Capital Market Authority	The Reasoning Document does not guarantee that the chosen pension product is best suited to the customer and does not solve the problem of conflict of interest of the insurance agent.					
The Pension Distribution Market	The Capital Market Authority	The absence of an objective pension consultation market.					
The Pension Distribution Market	The Capital Market Authority	Failure to examine the effectiveness of the enforcement.					



Summary

Pension savings are intended to serve as a main source of income after retirement from work and to enable the saver to live with dignity and maintain, to the extent possible, the standard of living he was used to before retirement. Choosing the type of pension savings and matching it to the member's preferences and personal needs considerably affects the pension he is expected to receive. The lack of adequate pension savings may lead to poverty after retirement, requiring public resources to support the pensioners. The findings in this report indicate that the Capital Market Authority rectified some of the deficiencies noted in the Previous Audit Report, mainly in the default funds and the management fees paid by retirees who retired as of February 2022. However, it did not rectify the deficiencies in the pension distribution market, manifested in the inherent conflicts of interest in the activities of pension insurance agents and the absence of an objective pension consulting market. The Capital Market Authority should address deficiencies in the pension distribution market, develop, and improve an objective and advanced pension consulting market to benefit public retirement savings.



Report of the State Comptroller of Israel |
November 2022

The Water Authority

The Supply of Drinking Water in Times of Emergency



The Supply of Drinking Water in Times of Emergency

Background

Water is an essential and existential commodity for humans and nature. The water sector incorporates diversity of entities responsible for various aspects of the production and supply of water and the maintenance of water infrastructures. These entities differ in size, nature (public or private), geographical location, operational characteristics, and importance to the water sector. The water suppliers include the Mekorot Company, 257 local authorities, 56 water and sewage corporations, and hundreds of other local water suppliers. According to the Water Authority: "In a situation of massive destruction of infrastructure, there may be temporary water shortages in different areas of the country due to the need to transport the water from areas that were not damaged." Therefore, an earthquake is the most serious reference scenario for which the water sector should prepare in terms of water supply in emergency.



Key Figures

about 2.4 million residents

residents of local authorities¹ not adequately prepared for water supply emergency

about 400,000 residents

the population to which the Water Authority is prepared to assist in an emergency, through its means, in addition to the water suppliers' means

over 1,000

water suppliers in the rural communities of which the Water Authority has no sufficient information regarding their emergency preparedness

in 18 hospitals (about 30%)

of the 59 audited hospitals supervised by the Ministry of Health, with no pooling of water required to meet emergency needs

about 13,161 hospital beds

are found in hospitals with water reservoirs that are not Earthquake-proofed

in about 38%

of the local authorities whose preparedness for emergency water supply was examined by the National Emergency Management Authority (NEMA) and the Water Authority, have no water distribution plan for populations that require special attention in the event of damage to the water supply


12 liters per person

residents are required to store in their homes for emergencies. The Water Authority has no information regarding the implementation of this directive

¹ It was found that some of these Local Authorities Incorporated in a water corporations, are not prepared for water supply in emergency even though their water corporation is prepared





Audit Actions

 From June to December 2021, the State Comptroller's Office examined the Water Authority and various water suppliers preparedness to supply drinking water in an emergency in the following aspects: the reference scenarios and service goal; the Water Authority's measures to prepare for water supply in emergencies; the water and sewage corporations, local authorities and hospitals preparedness to supply water in an emergency; tie-up of contractors during the recovery phase; coordination between the parties, the division of responsibilities between them and the enforcement of their instructions; and regulating the cyber protection and supervision of water suppliers. In addition, an analysis was carried out on information collected and processed from the audits findings in recent years by the Water Authority and NEMA in 95 of the 159 local authorities incorporated into water and sewage corporations; in 16 of the 23 local authorities required to incorporate that did not incorporate; in 51 of 54 regional councils and the water and sewage corporations. The audit was conducted at the Water Authority. Completion examinations were conducted at the Ministry of Energy, Health, NEMA, Mekorot, and the National Cyber Directorate (NCD).

Key Findings



-  **Establishment of a Command and Control System (C&C) for Water Crises and Supply of Water in Emergency** – as of the audit completion, December 2021, the Water Authority has not yet implemented the national C&C system for the water sector. In the absence of a system that gives a situation report, the ability to draw wide-ranging conclusions about the entire water sector, set priorities, and make decisions based on complete information is impaired and may also impair the ability to manage emergency events in the water sector.
-  **The Preparedness of Local Authorities for Water Supply in Emergencies** – about 2.4 million Israeli residents (about a third of the residents of the local authorities examined) live in local authorities that are not adequately prepared for water supply in emergencies. The percentages of audited local authorities not optimally prepared for water supply in an emergency are about 58% of the incorporated local authorities, about 62% of the audited local authorities required to be integrated and have not yet been integrated, and about 57% of the regional councils. It was also raised that 40 (about 75%) of the incorporated local authorities, whose level of preparedness for a water crisis is insufficient, are in high-intensity earthquake areas of level 8 or more.



- 📌 The Tie-Up of Contractors** – about 50% of the water corporations in the central and southern regions are not adequately prepared for an emergency regarding tie-up of contractors. It was also found that the Water Authority has no complete situation report of the contractors who provide essential services to corporations in an emergency. Therefore, it is difficult to ensure that each corporation has enough contractors who can provide a service recovering water infrastructures after a water supply crisis.
- 📌 The Gap Between the Water Corporations and the Incorporated Authorities' Preparedness to Supply Water in an Emergency** – about 87% of the corporations are almost very well prepared or highly prepared, compared to about 40% of the incorporated local authorities, which were similarly prepared. This gap may affect the overall ability to supply and distribute water to the local authorities' residents in an emergency.
- 📌 Preparedness to Assist Populations Requiring Special Attention in Case of Damage to the Water Supply (special attention populations)** – 36 of the 95 incorporated local authorities (about 38%) have no outline for distributing water to the special attention population.
- 📌 Regulation and Control in the Rural Sector** – the preparedness of the regional councils and the water suppliers in the rural sector for water supply in an emergency has not been fully regulated. The Water Authority does not conduct preparedness audits among over 1,000 water suppliers in the communities (including the local committees and the agricultural cooperative societies). It has no situation report on its readiness to supply water in an emergency.
- 📌 Storage of Water in Homes by the Residents** – according to the Water Authority guidelines, residents should store 12 liters per person at home to prepare for an emergency. The Water Authority has no data on the above mentioned, it did not raise the residents' awareness to store water as required, nor did it distribute questionnaires or surveys among the public to gauge their awareness to store water for emergencies. Therefore, the Water Authority has no situation report on the number and rate of residents prepared for the first days of an emergency event with no water in the taps.
- 📌 Distribution of Bottled Water in Emergencies** – one of the components of the national reserve is bottled water. The preparation of bottle manufacturers and supermarkets for producing water bottles and their distribution has not been regulated. The Water Authority has no written agreements with the bottle factories and supermarkets ensuring the preparedness of the bottle factories and supermarkets to supply bottles, transport and distribute them in an emergency to the citizens in the supermarkets.
- 📌 Pooling of Water in Emergency in the Hospitals** – in 18 (about 30%) of the 59 hospitals supervised by the Ministry of Health, the water pooling required to fulfill emergency needs is not carried out. In 5 out of 59 audited hospitals, there is a gap of





over 30% between the pooling volumes required for their functioning in an emergency and the volume available to them. The situation is dire in three private hospitals with no pooling; the water reservoirs in 39 hospitals, which are about 69% of the hospitals with water reservoirs, are not earthquake protected.



Establishing a Reserve of Equipment for Emergency Water Supply – the Water Authority established a reserve of equipment to serve as a backup for the alternative water distribution equipment found among the water suppliers to help the water suppliers in an emergency. As part of the aforementioned reserve, as of December 2021, the Water Authority holds equipment to distribute water to about 400,000 residents.

Initiating the Establishment of an Operational System – Mekorot Company initiated in September 2020 the establishment of an operational plan for the national water supply management, whose data will be made available to the Water Authority and can assist in managing emergency events. The system is intended to be operational in 2027, but parts are expected to operate starting in 2023.

Key Recommendations

-  It is recommended that the Water Authority ensure that the water suppliers will encourage residents to store water in their homes and that it examines their actions on the subject as part of the audits it carries out. It is also recommended that the Water Authority periodically survey the public's awareness of the need to store water for emergencies, among other things, through a survey based on the estimated number and rate of residents prepared for the first days of an emergency. It is also recommended that the Authority encourage water storage in homes through advocacy actions and cooperation with the Home Front Command.
-  It is recommended that the Water Authority and NEMA formulate a comprehensive plan to improve the preparedness of the local authorities whose level of preparedness for the supply of drinking water in an emergency is not adequate and implement it. It is also recommended that the Water Authority, the Home Front Command, and NEMA conduct joint training and exercises for the water corporations and the local authorities affiliated with those corporations to improve their preparedness level for an emergency from the citizens' perspective, and in particular in incorporated local authorities whose level of preparedness is not optimal, such as Hadera and the local authorities included in the "Great Shefaram Water & Sewage" corporation. In addition, it is recommended that the Water Authority and NEMA conduct repeated audits in local authorities that are required to be incorporated and have not yet been included, in particular in local authorities located in



areas prone to a relatively high risk of earthquakes that have not been audited in recent years; or that have been audited and found to be unprepared.



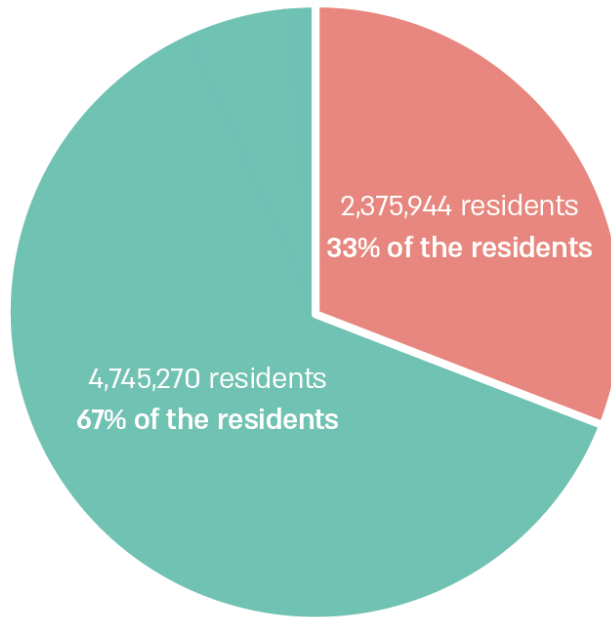
The Ministry of Health should ensure that water pooling is carried out as required in all hospitals, particularly in the government hospitals owned and supervised by the state. The hospitals that do not have sufficient reservoirs should establish the necessary water reservoirs and protect them from an earthquake. The Ministry of Health should prepare, in cooperation with the hospitals whose water reservoirs are not protected, a multi-year plan to minimize the disparities in this vital area and monitor its implementation.



It is recommended that the Ministry of Interior, as the regulator of the local government, the Ministry of Defense, the Home Front Command, the Ministry of Labor, Welfare and Social Services, and the Water Authority regulate the preparedness of the local authorities and the essential enterprises for civil emergencies such as an earthquake, including the regulation of appropriate measures, which will enable local authorities to enforce municipalities that are not adequately prepared for water supply during an emergency to fulfill their obligation regarding the required preparation. Furthermore, it is recommended that the Ministry of Energy and the Water Authority regulate the formulation of water security rules, as stipulated in the Water Law.



The Number and Rate of Residents in Audited Local Authorities, Segmented According to Their Level of Preparedness for Water Supply in an Emergency



■ The extent of preparedness
"unprepared" – "well prepared"

■ The extent of preparedness
"almost very well prepared" –
"highly prepared"

According to the State Comptroller's Office's analysis and processing of the findings of audits conducted in recent years by the Water Authority and NEMA in 95 of the 159 local authorities that were incorporated into water and sewage corporations, In 16 of the 23 local authorities required to incorporate and that were not included; In 51 of 54 Regional councils and the water and sewage corporations.



Summary

Water is an essential and existential commodity for humans and nature. Disruption of the water supply or damage to drinking water quality may affect public health and orderly life routines. The potential threats to the water supply are diverse and may materialize without prior warning. According to the National Emergency Management Authority (NEMA) and the Water Authority, the most severe reference scenario the water sector should prepare for in terms of water supply during an emergency is an earthquake.

The Water Authority has no information on the amounts of water the residents store for times of emergency. It has not raised the public's awareness of the need to store water as required, and the water suppliers are not fully prepared for an alternate water supply. 30% of hospitals have no water reservoirs sufficient to meet their emergency needs as required, and in three hospitals, no emergency water reservoir was even established. The water reservoirs in most hospitals are not earthquake protected. The Ministry of Interior, the Water Authority, and NEMA should improve the preparedness of small local authorities with a low socio-economic level for water supply in an emergency. It is recommended that these entities consider providing an alternative solution for water supply in the first hours after an emergency. The Ministry of Energy, the Water Authority, the Ministry of Health, and the hospitals should consider the recommendations in this audit report and rectify the noted deficiencies.



Report of the State Comptroller of Israel |
November 2022

Civil Aviation Authority

Civil Aviation Safety



Civil Aviation Safety

Background

The aviation industry in Israel is of great strategic importance from defense and economic aspects. It is the primary transportation means for passengers in and out of the State of Israel. In aviation, human error or a technical malfunction may have severe consequences to human life onboard and on the ground. Therefore, the aviation industry is characterized by a high level of regulation and laws. Under the Civil Aviation Authority Law, 2005, the Civil Aviation Authority (CAA) is responsible for the regulation of the aviation sector in Israel, including licensing procedures, supervision and control of aircraft, airlines, flight crews, testing institutes, and flight schools, and for the ongoing maintenance of the aircraft's and flight crew's competence.

According to CAA data, in 2019, and before the covid-19 pandemic, there were 115 accidents in commercial and civil aviation worldwide, higher than the five-year average, which is 90.2 accidents. The total number of fatalities that year was 239 passengers and crew members. This increase in the number of accidents and the accident rate worldwide in commercial and civil aviation broke a long-standing streak of decrease in the global accident rate until 2016.



Key Figures

**1,159
and
7,831**

in 2021, there were 1,159 CAA-licensed aircraft in Israel and 7,831 CAA-licensed pilots. An increase of 27% and 9.3% compared to 2018 (respectively)

**59 airports
and landing
strips**

operated in Israel in 2021, of which 54 are landing strips, compared to 87 airports and landing strips in the past, of which 80 were landing strips. Most of the landing strips serve agricultural spraying aircraft and are not for public use

1,749

aviation safety incidents in Israel in 2021, 33 of which were severe. In 2020 – 1,318 incidents, 21 of which were severe; In 2019 – 2,677 incidents, 39 of which were severe¹

18

the number of aviation accidents in Israel in 2021, 9 in general aviation and 7 in sports aviation. In 2020, 29 accidents occurred; In 2019 – 39; In 2018 – 54

6

fatalities and 9 injured in aircraft accidents in 2021 in Israel. In 2020, the fatalities and wounded in aircraft accidents were 2 and 10, respectively; and in 2019 – 2 and 14, respectively

**25%–33%
only**

the recommendations rate noted in the Ministry of Transport's Chief Investigator's reports completely implemented by CAA in 2019–2021; And in 2017–2018 – 41%–50%, respectively

52

Israel's ranking out of 193 countries by the ICAO organization indicating compliance with global safety standards and aviation regulatory bodies effectiveness


11 years

since the government recognized the national need to establish another international civil airport as a complementary airport to Ben Gurion Airport (July 2011)

¹ In 2020 and 2021, the aviation industry wasn't very active due to the coronavirus, and accordingly the number of reports decreased.






Audit Actions

 From March 2021 to March 2022, the State Comptroller's Office examined civil aviation safety, including airspace management, the cyber threat in aviation, compliance with international standards, the aviation infrastructure, and the investigation of aviation accidents and incidents. The audit was conducted at the Civil Aviation Authority, and completion examinations were done in the Airports Authority (IAA) and the Israel Police.

This report was presented to the Prime Minister on July 31, 2022, and was classified as confidential until its discussion at the State Audit Committee's Subcommittee. Under the authority vested upon the State Comptroller in Section 17(c) of the State Comptroller's Law, 1958 [Consolidated Version], considering the government's reasoning, consulting with the bodies entrusted with the security of defense information, in coordination with the Knesset chairman, and as the said subcommittee did not convene, it was decided to publish this report while classifying as confidential parts thereof. These sections will not be submitted to the Knesset and will not be published.

The audit report's findings and recommendations are correct as of the aforementioned date of its publication.

Key Findings

- 
-  **CAA's Supervision of Aviation Activity** – the aviation industry in Israel is growing, and its activity is increasing. In 2018–2021 the number of aircraft (1,159 in 2021 compared to 913 in 2018), of pilot license holders, including trainees (7,831 compared to 7,164), of airlines and aviation entities (88 compared to 78) increased. Still, it was found that the number of CAA inspections declined from 899 planned in 2021 to 1,035 in 2019. Moreover, in 2019 and 2021, the execution rate of the planned inspections was about 90%, compared to 82.7% in 2020 due to the Covid-19 pandemic. In 2020, the inspections of commercial aviation operators and routes decreased (a field related to commercial aviation operators) to 48.8% and 26.3%, respectively, compared to the planned number. In 2021, recovery was evident, but the execution rate of the inspection activities compared to the number planned has not returned to pre-Covid-19 levels.
-  **Traffic Management in Israel's Airspace** – Israel's airspace is divided into three: airspace for civil aviation use, airspace for military aviation use allowing civil aviation use, and airspace for military aviation use only. The airspace for civil aviation use is limited, and most of the airspace and air traffic is controlled by the Air Force. It was raised that



the increase in the domestic light aircraft activity operating in the areas managed by the Air Force creates a burden on traffic management, which could affect domestic aviation safety. However, the IAA does not supply the Air Force with adequate data and tools for civil aviation management, such as flight planning data and auxiliary systems equipment, and the IAA's budgetary participation the Air Force received was terminated by the IAA unilaterally.

Use of Air Force Equipment to Manage Civil Air Traffic – the Air Force equipment to manage civil air traffic does not meet the performance and maintenance requirements of the ICAO organization² and Israeli law. The CAA could not perform civilian inspection on said equipment as the system is military. The IAA was not allowed to access the military's information. Moreover, the Air Force's maintenance procedures do not meet civilian standards as required by ICAO requirements.

IAA's Supervision of Air Traffic Through the ARTS System – the ARTS system (Automated Radar Terminal System) is a computerized air traffic management system enabling the air traffic controller to track aircraft. The system combines all the updated information from humans and radars to create a more accurate aerial picture. It was raised that over the years, the system can no longer be maintained due to high costs and the obsolescence of its components. Moreover, due to the system's obsolescence, making changes and adjustments in an advanced and modern flight control environment is impossible. The outdated ARTS system does not meet ICAO requirements and international standards.





Forming the Aerial Screen Display – the Air Force control units operate according to military standards, which are different from those of civil aviation and do not always coincide with the international rules designed to maintain civil aviation safety to which the State of Israel is committed. It was found that for two months from August 10, 2021, there were 11 malfunctions in the aerial picture, including an aircraft that disappeared from the screen; Momentary or five seconds image disappearing, and low tracking ability after the image reappearing; screen display delay of aircraft coming from the west; Multiple screen display delays incidents of aircraft taking off from Tel Aviv; And low tracking of aircraft from the West. Such malfunctions may affect the safety of Israeli and international civil aviation operating in Israel's airspace and harm the efficient management of civil air traffic.

The Interrelationship Between the IAA and the Air Force – it was raised that critical issues of air traffic management, posing a safety risk to civil aviation and to the efficiency of air traffic management, require cooperation between the IAA and the Air Force, are not resolved due to disagreement over the following issues: providing mutual services; Improving the quality of the aerial display and its reliability; And the control

² International Civil Aviation Organization – The international body working to ensure uniformity in the regulations, rules and standards of civil aviation between countries.




units physical conditions increasing manpower on duty due to the increase in air traffic in Israel's airspace. The mutual services agreement between the Air Force and the IAA expired on December 31, 2019, and at the audit completion, it was not renewed.


-  **Electronic Jamming** – electronic jamming may affect the safety level of civil aircraft. It was raised that the IAA occasionally experiences electronic jamming and that its tools are not effective enough to handle such jamming, to inform the flight crews of the jamming and of the alternatives they should take.
-  **Closing the Herzliya Airfield and Finding an Alternative Field** – the Herzliya Airfield was active and founded even before the establishment of the state. It has been operated by the IAA since 1978, and it is currently used as the main general aviation airport in Israel to operate flight schools and maintain pilot qualifications. In 2009, the National Council designated the Herzliya field as a temporary field due to its location in a populated area, and the Israeli government considered and promoted an alternative field for the Herzliya field in the Ein Shemer area. Despite the great importance of establishing a central airfield for the general aviation industry, and even though closing the Herzliya field has been on the agenda since 2009, and 13 years have passed since the government's resolution 2009, the Ministry of Transportation and the IAA have not found a suitable alternative to the Herzliya field. Moreover, the Herzliya field is on land defined as agricultural, and it operated all these years without planning regulations as an airfield. Notwithstanding, during the decades of the field's activity, the Ministry of Transportation and the IAA did not statutorily regulate the field and permitted its operation.
-  **The Establishment of a Supplementary Airport to Ben Gurion Airport** – despite the government's resolution to promote a supplementary airport to Ben Gurion Airport in July 2011 and October 2014, recognizing the urgent need to establish another international civil airport, and despite the professionals' recommendations in November 2017 about the preferred and applicable alternative, from the defense, aviation, and economic aspects, the location of an additional airport was not decided upon. The matter reappeared in the government's resolution in October 2021.
-  **Investigation of Aviation Accidents and Incidents** – under the Aviation Law, 2011 (the Aviation Law), the Minister of Transportation appointed a chief investigator for safety investigations.
 - It was raised that in 2017–2021 there were differences between CAA's data and the Chief Investigator's data, especially on accidents and injured persons. The Chief Investigator's figures were usually higher than CAA's figures. Regarding the number of fatalities, there were no differences in those years. The Chief Investigator's figures for 2017–2021 regarding accidents were higher than CAA's data by 3.6% up to 54.3%, And regarding injured persons – by 12.5% up to 180%. The main differences were before the covid-19 pandemic when civil aviation operated without restrictions and under normal conditions. The differences between the figures for



accidents in 2017, 2018, and 2019 were 34.6%, 54.3%, and 18.2%, respectively, And the differences between the figures for injured persons in those three years were 14.3%, 162.5%, and 180%, respectively.

- It was raised that the Chief Investigator's recommendations rate implemented by the IAA in 2017–2021 is lower than 50%, and in the three years 2019–2021, the rate varies between 25% and 33% only. In 2017 and 2018, the Ministry of Transportation was given seven and four recommendations, respectively, but none were implemented.
- It was raised that in 2017 there was a decrease in the number of final investigation reports from 28 in 2017 to 15 in 2021, a decrease of about 46%. In 2020, eight final reports were issued due to the Covid-19 pandemic and a decrease in civil aviation activity.
- It was raised that as of the audit completion, March 2022, an independent investigating authority had not been established according to the international standards set by ICAO. Moreover, the Ministry of Transportation notified the ICAO in June 2017 that establishing an independent investigative authority would be addressed by March 1, 2019. In ICAO latest inspection report, it recommended establishing an independent investigation authority. In its absence, the State of Israel's score in the area of aircraft accident investigation dropped from 91% to 63%.

 **Cyber Supervision of the Commercial Aviation Operators** – it was raised that the Commercial Aviation Operators³ were not defined as critical state infrastructure (CSI). Therefore, they are not under the professional supervision of the National Cyber Directorate regarding information security operations. The IAA's ability to supervise Commercial Aviation Operators, testing institutes, and manufacturing industries is limited due to the lack of appropriate authorizing legislation to supervise civil aviation's cyber protection effectively. Furthermore, as of the audit completion, disparities were raised in the IAA's manpower and budget, necessary for supervision in cyber protection.

 **Preparedness for an Aviation Disaster** – it was raised that as of the audit completion, March 2022, Police Ordinance instructions for joint operation, regulating civil emergency events, and the necessary coordination between the police and the rescue agencies operating in the field had not been formulated. Without joint operation instructions, no professional instructions had been written by any of the rescue agencies. Moreover, the search and rescue in an accident not within an airport area is not fully regulated. Hence, the various organizations' search and rescue array operates according to practice, not within a fully regulated and pre-agreed framework, and without division

3 Companies engaged in the commercial operation of large aircraft, pursuant to Chapter 13 of the Aviation Regulations (Operation of Aircraft and Aviation Rules), 5742-1981.







of responsibilities and powers between the parties involved. Therefore, the management of a search and rescue event varies from case to case and is affected by ad hoc decisions and improvisations that may lead to a less-than-optimal result. It was also raised that no exercises simulating a mass aviation disaster outside the airport and in an urban area are being carried out, and the ability of the bodies involved to cope with this type of incident has not been tested.



The Rise in Israel's Ranking – the IAA improved Israel's score in the ICAO test in 2014 and raised Israel's overall ranking compared to other countries from 105th place to 21st place. However, following another ICAO test in Israel in 2016, in aircraft accident investigations, Israel's overall score declined from 21st to 39th place. As of June 2022, Israel's overall ranking was 52nd.

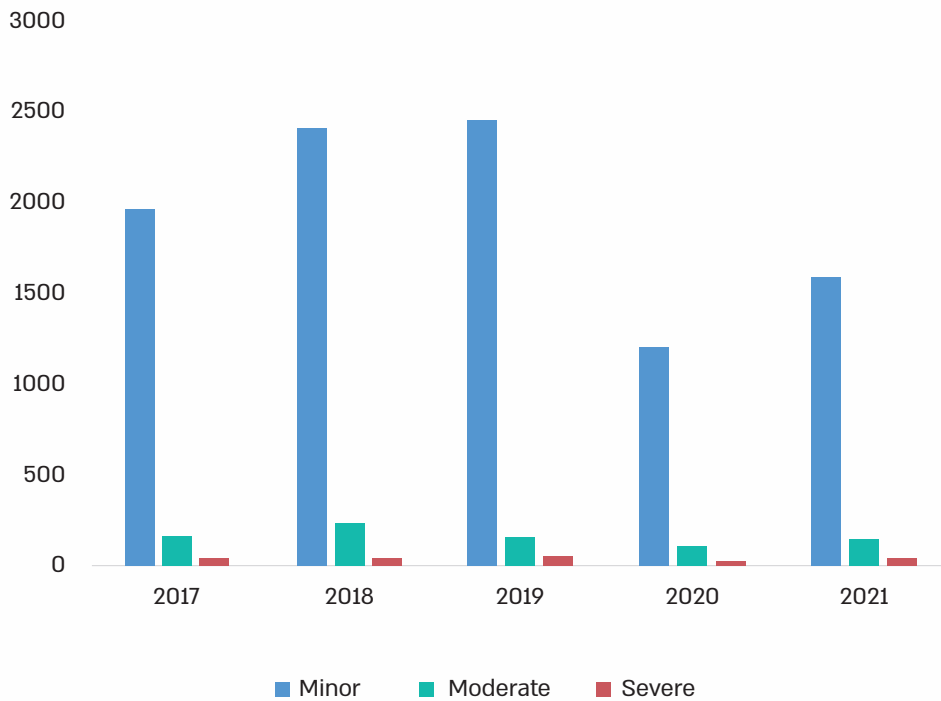
Key Recommendations

-  It is recommended that the Ministry of Transportation, the IAA, and the Ministry of Defense, given the continuous expansion of civil aviation activity, examine in depth from time to time the allocation of airspace for various uses, considering the interests of the defense, civil aviation safety and air traffic management, economic, and of Israel's foreign relations.
-  It is recommended that the IAA, the CAA, and the Air Force not settle for regulating an exemption for the outdated auxiliary flight facilities but also ensure that all the facilities used by the IAA for air traffic control, meet the international standard, including the radars and the Air Force's information processing system, and the IAA's ARTS system, to improve the level of aviation safety. The IAA should refine its procedures and methods of dealing with electronic jamming, consider, with the approval and cooperation of the IAA, new ways and technologies for coping, and pass them to the airlines. It is also recommended that the Air Force and the IAA increase their collaboration on electronic jamming.
-  It is recommended that the IAA and the Air Force examine in depth the cooperation level between them regarding the management of civil air traffic and the reasons and causes – human and technological – for the many malfunctions, consider upgrades and updates of the systems to increase their reliability, conduct investigations and draw lessons in each case of malfunction, create joint working procedures for the IAA and the Air Force and build a mutual coordination system, all this to improve conduct in the control units, prevent unnecessary risks and improve the safety of civil aviation according to the accepted standards in the world.
-  The Ministry of Transportation is recommended to establish an independent investigation authority according to internationally accepted standards and ICAO's recommendation from June 2017. The IAA is recommended to fully implement the supervision's work plan,



particularly regarding commercial aviation operator and route supervision. It is recommended that the IAA, the Ministry of Transportation, and the National Cyber Directorate cooperate with the Ministry of Finance and the Civil Service Commission to consider allocating resources and recruiting suitable personnel for implementing the policy and the recommendations to improve cyber protection in aviation.

The Number of Reports on Aviation Safety Incidents in Israel



According to IAA data processed by the State Comptroller's Office.



Summary

By the audit, issues related to aviation safety have not been regulated or are not at the optimal safety level. The findings indicate that air traffic management in cooperation with the Air Force in Israel's congested airspace is done with outdated equipment that is not adapted to advanced technologies, and with auxiliary flight facilities that do not meet the international standard and the requirements of Israeli law, creating malfunctions in the aerial screen display and affect the safety of air traffic and the efficiency of its management; For years, there has been no response to infrastructure ventures that are essential for both the development of aviation and for safety, such as a supplementary field to Ben Gurion Airport and an alternative field for general aviation; The rate of the recommendations of the Ministry of Transportation's Chief Investigator implemented by the IAA ranges in 2019–2021 between 25% and 33%, affecting the lessons drawing from investigation, and preventing accidents and incidents in the future; The IAA cannot improve cyber aviation regulation and maintain effective supervision of aviation entities, in the absence of authorizing legislation, of personnel and budget measures; In the following – licensing of companies, general operation of airplanes and helicopters, licensing of pilots and testing institutes – the standard in Israel does not meet international standards, and out of the 1,827 ICAO standards, 670 (37%) are partially implemented, affecting Israel's safety rating compared to other countries.

It is recommended that the CAA, the Ministry of Transportation, the IAA, and the Air Force rectify the deficiencies raised in this report and consider implementing their recommendations. Among other things, they should address the airspace and air traffic management; Reconcile the differences of opinion between the IAA and the Air Force on this issue; Promote the use of auxiliary flight facilities that meet the international standard; develop aviation infrastructure, all of this to improve aviation safety and enable efficient aviation management.

