



Report of the State comptroller of Israel | January 2024

The Government Water and Sewage
Authority

**The Water and
Sewage Corporations
– Regulation,
Management, and
Supervision – Follow-
up Audit**



The Water and Sewage Corporations – Regulation, Management, and Supervision – Follow-up Audit

Background

The Water and Sewage Corporations Law 2001 regulates the transfer of the water and sewage sector management from the local authorities to designated companies owned by them – water and sewage corporations (the Incorporation Reform).

As part of the Incorporation Reform, the above transfer is intended to solve structural failures, particularly underinvestment in water and sewage infrastructure, as some local authorities diverted the revenue from water consumers to finance other municipal areas. The corporations were established to provide water and sewage services in a closed financial economy where, as a rule, the revenues from water consumers finance the provision of water and sewage services and are invested in the water and sewage infrastructure.

In October 2020, the state Comptroller's Office published the "Water and Sewage Corporations – Regulation, Management, and Supervision" Audit Report (the previous report or the previous audit)¹. In which, a comparison was made between the situation of the corporations at the time the Incorporation Reform began in 2011, when 52 corporations were incorporated, and their situation in 2018, according to financial and quantitative indicators, including profitability and financial strength, water loss, collection loss, operating costs, investments, grants and subsidies through the tariff.

As of the follow-up audit end date, January 2023, municipalities and local councils are required to incorporate by law, as Water and Sewage Corporations, whereas, regional councils are not required to do so.

1 The State Comptroller, Annual Report 71A (October 2020) "Water and Sewage Corporations – Regulation, Management and Supervision", p. 1391.



Key Figures

NIS 6.25 billion

the cumulative investments of all the water and sewage corporations in water and sewage infrastructures in 2018–2021

56 corporations

exist as of the follow-up audit end, though according to the Government Water and Sewage Authority's association map (the Water Authority), only 30 regional corporations are required to incorporate. However, in January 2023, the restriction according to which the number of corporations should not exceed 30 was abolished

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local authorities required to incorporate have not yet incorporated in January 2023. During the follow-up, only one local authority joined an existing corporation – Jisr az-Zarqa

only about NIS 7.5 million (about 1%)

are designated as reimbursement to consumers by only one water corporation – Mey Ono – in 2022, out of about NIS 745.3 million that the Commissioner approved to be reimbursed for all corporations in 2014–2022

about NIS 1.7 million

the average loss of "eligible corporations"² in 2021, compared to an average profit per corporation of NIS 7.3 million among non-eligible corporations

about NIS 162 million

the subsidy the eligible corporations received from the rest of the corporations through the tariff in 2021, when there were 13 eligible corporations. About 40% over the subsidy in 2018 and about 245% over the subsidy in 2011, when there were 11 eligible corporations


about NIS 225 million

about 52% of the benefits budget for entitled persons under the Water Bill Assistance Mechanism in 2015–2021 was not used

² The Water Authority defined weak corporations as "entitled corporations", with particularly high-water loss ratios that are incapable of independent financial subsistence during their initial years of operation, and are eligible for grants and more lenient norms.





Audit Actions

 In January 2023, the State Comptroller's Office performed a follow-up audit of its 2020 report on the Water and Sewage Corporations – Regulation, Management and Supervision³. The follow-up audit examined the actions of the Government Water and Sewage Authority, the Ministry of Finance – The Budget Division, and four water and sewage corporations with different characteristics that were examined in the previous audit, "Mey Barak," "Neve Midbar," "Mey Ramat Gan" and "Mey Lod," to rectify the critical deficiencies noted in the previous audit. Completion examinations were conducted at the Ministry of Interior and the Federation of Local Authorities in Israel.

Key Findings



 **Regional Incorporation** – the previous audit found that the provisions of the regional incorporation law were not implemented. The number of corporations was not reduced, and the Water Authority's regional incorporation outlines in 2013 and 2019 were not executed despite the incentives and grants offered by the Water Authority to encourage regional incorporation. **According to the follow-up audit, the deficiency was not rectified:** the regional incorporation outline was not implemented, no regional corporations were established according to the association map published in May 2020, and the number of corporations remained at 56 instead of 30. However, it should be noted that the Supreme Court heard motions on the subject, and in June 2023, Amendment No. 15 to the Water and Sewage Corporations Law was published. Accordingly, the deadline to implement the obligation for regional incorporation was extended to January 1, 2025, and the limit that regional corporations should not exceed 30 was repealed.

 **Local Authorities Required to Incorporate that have not yet Incorporated** – the previous audit found that 24 local authorities required to incorporate have not incorporated. **According to the follow-up audit, the deficiency has not been rectified:** only one local authority (whose ranking in the socio-economic index is 2⁴ –

3 The State Comptroller, Annual Report 71A (October 2020) "Water and Sewage Corporations – Regulation, Management and Supervision", p. 1391

4 The Central Bureau of Statistics formulated an index to characterize the local authorities in Israel according to the socio-economic level of the population therein. The local authorities were classified according to the index values into ten clusters, where cluster 1 indicates the lowest socio-economic level and cluster 10 indicates the highest socio-economic level.



low ranking), required to incorporate (Jisr az-Zarqa) joined a multi-authority corporation, whereas 23 local authorities needed to incorporate (whose average socio-economic index is 6.3) have not incorporated, despite the requirement to incorporate was established by law.


Financial and Operational Indicators in the Eligible Corporations Activity Compared to the Non-Eligible Corporations – the previous audit found that despite the subsidies and grants the eligible corporations received since 2010, most remained in need of assistance. **According to the follow-up audit, the deficiency has not been rectified:** the subsidy mechanism did not promote the entitled corporations to economic independence, and the gap between them and the non-eligible corporations grew considerably in profitability and financial stability and even in the operational water loss. The current assistance given within the subsidy increased over time. Below are the findings of the comparison between the situation of the eligible corporations in 2018, when there were 11 eligible corporations, and their situation in 2021, when there were 13 eligible corporations, and this compared to the position of the non-eligible corporations in these years:


- **Profitability** – in 2018–2021, the total profit of the non-eligible corporations increased by about 17% (from NIS 267.67 million to NIS 313.94 million). Still, the total profit of the eligible corporations decreased. They transitioned from a profit (albeit small, in the amount of approximately NIS 1.98 million) to a loss (in the amount of approximately NIS 22.1 million). The average annual profit per corporation among the non-eligible corporations increased by about 23%; however, the average annual profit per corporation among the eligible corporations, which was about NIS 180,000 in 2018, decreased considerably when they went from profit to loss and ended the year with a loss of about NIS 1.7 million. Furthermore, the average profit per consumer in a corporation among the non-eligible corporations increased by about 17%. Still, among the eligible corporations, the average profit per consumer turned into a loss.
- **Financial Strength** – the follow-up audit found that the average financial leverage of the eligible corporations increased from 59% in 2018 to 66% in 2021. Despite the assistance given to the eligible corporations from the water tariff and the state budget, their financial strength did not grow as reflected in their average leverage and even lessened considerably.
- **Water Loss** – the follow-up audit found that in 2018–2021, the average water loss rate decreased both in the eligible corporations (from 21% to 18%) and in the non-eligible corporations (from 7% to 6%), that is, on average, there was an improvement in the water loss rates. However, the average loss rate of the eligible corporations remains three times greater than that of the non-eligible corporations. The follow-up audit also found that in 2021, as in 2018, the highest water loss value



was in the "Neve Midbar" corporation, and it increased from 36.1% in 2018 to 40.3% in 2021.

- **The Subsidy Mechanism Built into the Water Tariff** – in 2018–2021, there was an increase of about 40% in the annual subsidy received by the eligible corporations from the rest of the corporations within the tariff, and in 2011–2022, there was an increase of about 245% in the said annual subsidy (NIS 47 million in 2011, NIS 116 million in 2018 and NIS 162 million in 2021).

 **Designation of the Financial Surpluses of the Water Corporations as Reimbursement to Consumers** – since 2014, the water corporations may designate their profits as dividends to the local authorities or as reimbursements to their consumers. Thus, lowering the cost of water and sewer services to its consumers. It was found that under the distribution of profits rules, in 2014–2022, the Commissioner approved to designate profits of about NIS 745.3 million, of which about NIS 737.8 million were distributed as dividends to the local authorities in 2014–2020 and only about NIS 7.5 million were designated in 2022 as reimbursement to consumers by only one corporation – the Mey Ono Corporation.

 **The Treatment of Populations Deserving of Advancement** – the previous audit found that despite the Finance Committee guidelines from May 2017 and even though the Water Authority proposed the Ministry of Finance to amend the regulations already in May 2017, the Ministry of Finance did not submit to the Finance Committee a proposal to amend the regulations, and the aid mechanism remained unchanged. **According to the follow-up audit, the deficiency has not been rectified:** the aid mechanism has not been amended, and the Ministry of Finance has not submitted a proposal to the Finance Committee to amend the regulations. This is despite the instructions of the chairman, at the time, of the Economic Committee in the Economic Committee's discussion of the previous audit report's findings on the subject in February 2022, and even though the representatives of the Ministry of Finance and the Water Authority agreed that the existing aid mechanism is ineffective and should be replaced. In 2015–2021, about NIS 243 million was budgeted for benefits for eligible populations, at about 42% of the budget, but was not utilized.







Designation of Water Corporation Profits as Reimbursement to Consumers – the State Comptroller's Office commends the decision of the Ono Water Corporation Ltd. board of directors, given its operating profits that year, to distribute its profits of NIS 7.5 million as reimbursement to its consumers in 2022, thereby reducing their water and sewer bills.

Water Loss – the follow-up audit found that since the previous audit, the Mey Barak and Mey Lod corporations have reduced their water loss in 2018–2021.



Key Recommendations

-  The Water Authority and the Ministry of Finance should map all the barriers to implement the regional incorporation requirement, implement solutions to remove them, and encourage the local authorities to incorporate together as required.
-  The local authorities that have not yet done so, are required to apply the law and incorporate into water corporations as needed. To implement the incorporation requirement under the law, it is recommended that the Ministry of Finance, the Water Authority and the Ministry of Interior, the Federation of Local Authorities, and the local authorities cooperate to remove the barriers, including reducing the gap in the state of the infrastructure between them and the local authorities with which they are required to incorporate.
-  It is recommended that the Water Authority consider setting incentives to designate corporate profits as reimbursement to their consumers or leave them in the water sector for additional development plans⁵.
-  The State Comptroller's Office reiterates its recommendation in the previous audit for cooperation between the Ministry of Finance, the Ministry of Energy and Infrastructure (Ministry of Energy), and the Water Authority to improve the situation of eligible corporations, and even recommends that if formulating a comprehensive systemic solution requires it, the Ministry of Energy should propose the government to establish an inter-ministerial team or initiate joint discussions. It is recommended to consider in addition to representatives from the Ministry of Finance, Ministry of Energy and Infrastructure, and the Water Authority, that representatives of the Ministry of National Security, the Israel Police, and the Federation of Local Authorities participate in the inter-ministerial team or these joint discussions, similar to the discussions at the audit end date between the Water Authority and the Federation of Local Authorities, with the participation of the Ministry of Energy and Infrastructure which receives updates through the Water Authority and through which it conveys its position. The participation of representatives from all of the entities above in the inter-ministerial team or the joint discussions is to systemically address the eligible corporations' situation from an overall perspective, considering all aspects, so these corporations operate independently from an economic point of view, instead of dependent on ongoing subsidies from others corporations through the tariff. It is further recommended that the Ministry of Finance, the Ministry of National Security, and the Water Authority address each eligible corporation individually to bring them to economic independence.

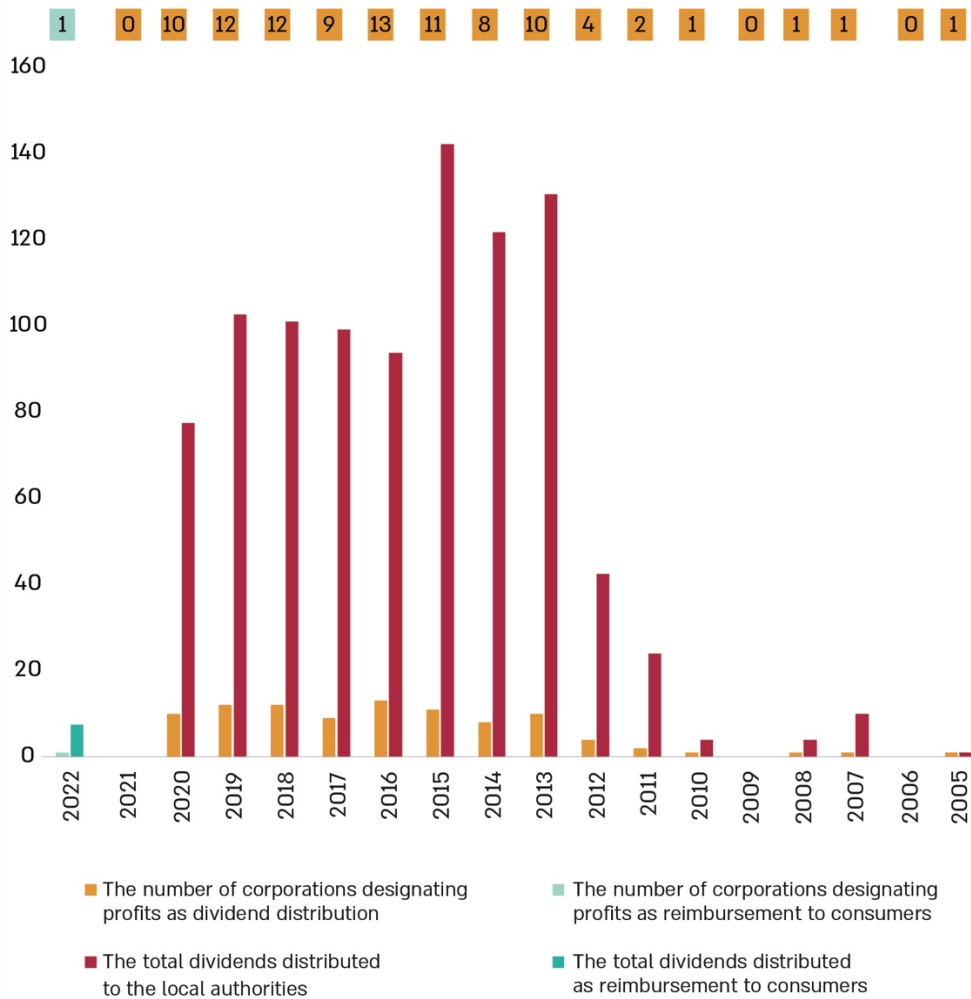
⁵ Additional development plans beyond the scope of plans whose execution is required according to the existing rules in order to approve the designation of profits as a dividend or as a consumer reimbursement.



The Ministry of Finance, entrusted with the amendment to the regulations, should promote a procedure for changing the aid mechanism for eligible populations; hence, those entitled to this benefit efficiently exhaust it. It is further recommended that the Ministry of Finance consider including additional groups of disadvantaged populations in the list of those entitled to the benefit to alleviate the burden of paying water bills since water is an essential consumer product. This, while changing the aid mechanism for eligible populations, enables those entitled to this benefit to exhaust it efficiently and effectively.



The Profits that the Water Corporations Designated as Dividends to Local Authorities and as Reimbursement to Consumers (in NIS millions) and the Number of Corporations that Designated Profits for These Purposes, 2005–2022



According to the data of the Water Authority, processed by the Office of the State Comptroller.



Summary

The transfer of responsibility for the management of the water and sewage system to water and sewage corporations as part of the Incorporation Reform is intended, among other things, to solve structural failures that have arisen in the management of the water and sewage system in the local authorities and to ensure an adequate level of service as well as business and professional management. The previous audit examined, among other things, the achievement of the Incorporation Reform's goals.

The follow-up audit found that since the previous audit's end date, there have been improvements in a few matters examined in the previous audit. Among other things, one local authority required to incorporate has been incorporated, and the Water Authority Director appointed in December 2022 a team to examine the situation of the corporations receiving support, including the eligible corporations. However, the audited entities did not rectify a large part of the deficiencies that were raised in the previous audit, including: failure to regionally incorporate; 23 local authorities that are required to incorporate have not incorporated; The audit recommendation to remove a significant barrier was not implemented, resulting in opposition in the local authorities with solid and medium socio-economic ranking and in a lessening of their willingness to merge with local authorities with a low socio-economic ranking – the gap between these authorities in the state of the infrastructure due to many years of neglect in this area in local authorities with low socio-economic ranking; Despite the current subsidy financed from the water tariffs and the grants financed from the state budget, not only was the goal of bringing the eligible corporations to economic independence not achieved, but the gap between them and the non-eligible corporations has grown considerably in profitability and financial stability and even in the operational water loss, and their dependence on current financing from non-eligible water corporations is increasing (from NIS 47 million in 2011 to NIS 162 million in 2021). It was further found that the aid mechanism for populations deserving of advancement is ineffective.

The Ministry of Finance, the Water Authority, and the Federation of Local Authorities in Israel should rectify the deficiencies found in this report.



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

The Deficiency in the Previous Audit Report	The Audit Chapter	The Rectification Extent of the Key Deficiencies Noted in the Follow-up Audit			
		Not Rectified	Slightly Rectified	Significantly Rectified	Fully Rectified
Regional incorporation	The regional incorporation law provisions were not implemented. The number of corporations has not been reduced.				
	The association maps published by the Water Authority were not implemented.				
Local authorities that have not yet been incorporated	24 local authorities required to incorporate did not incorporate (during the follow-up, only one local authority has incorporated).				
Financial and operational ratios in the operation of the eligible corporations compared to the non-eligible corporations	Notwithstanding the subsidies and grants the eligible corporations received since 2010, most still require assistance.				
	In the previous report, the audit recommended that the Ministries of Finance and Energy and the Water Authority cooperate in contending with the unique difficulties of the eligible corporations and solve the mix of problems that characterize these corporations systemically.				



The Deficiency in the Previous Audit Report	The Audit Chapter	The Rectification Extent of the Key Deficiencies Noted in the Follow-up Audit			
		Not Rectified	Slightly Rectified	Significantly Rectified	Fully Rectified
The Water Authority's reports to the public regarding the water and sewage corporations	Publication of the annual financial reports of the water and sewage corporations on the Water Authority website.				
	Reporting on the corporations as part of the Water Authority's annual activity report.				
The treatment of populations deserving of advancement	Exhaustion of rights and benefit utilization.				
	Failure to implement the Knesset committees' guidelines regarding changing the aid mechanism.				
	Populations deserving of advancement.				

