



Office of the State Comptroller
Annual Report 71A | 2020

Ministry of Finance

Management of Civil Servants' Pension System

Abstract

Management of Civil Servants' Pension System

Abstract

Background

A budgetary pension is paid in Israel by virtue of the Civil Service Law (Pensions), 5730 – 1970. The budgetary pension payments are taken from the State budget. Additional laws regulate the payment of the budgetary pension from the State: the Career Service in the Israel Defense Forces (Pensions) Law [Consolidated Version], 5745 – 1985; and the Pensions for Officers in Government Authorities Law, 5729 – 1969, which relates to pensions for functionaries specified in the law. The purpose of these laws is to ensure the payment of a retirement allowance, a survivor allowance and a disability allowance to retired civil servants. The Minister of Finance is responsible for the implementation of the Pension Law, while the Accountant-General in the Ministry of Finance is responsible for the pension payments pursuant to the law. The Pension Administration in the Ministry of Finance is part of the Wage Division in the Accountant-General's department, and it is responsible for paying the budgetary pension payments to civil servants and to employees of other defined organizations who have retired.

Key figures

ILS 10 billion

total payments to pensioners in 2019 by the Pension Administration

ILS 900 million

total payments to surviving relatives in 2019 by the Pension Administration

ILS 649 billion

the State's total liabilities for budgetary pension at the end of 2018 (the State's liability to the Security Establishment is ILS 266 billion)

ILS 320 billion

the Pension Administration's share of the liabilities for budgetary pension at the end of 2018

91,000

number of pensioners who received a retirement allowance from the Pension Administration in 2018

15,000

number of surviving relatives who received a survivor allowance from the Pension Administration in 2018


ILS 36 billion

record high budgetary pension payments expected in 2038





70% of the determining wage

employee's maximum accumulated rights for all years of employment, apart from special cases

Audit actions

-  From November 2019 to March 2020, the Office of the State Comptroller audited the budgetary pension approval process, the pension payment process and the controls over them in the Pension Administration. Supplementary examinations were conducted in the Ministry of Finance and in the Civil Service Commission.


Key findings

-  **Crosschecking of information about pensioners' additional sources of income with the National Insurance Institute** – in 2014, the Pension Administration received information from the National Insurance Institute about the existence of 178 pensioners with additional sources of income. The Pension Administration wrote to these pensioners in order to clarify the matter, but failed to follow up on pensioners who did not respond to its letter and failed to ascertain whether their allowance should be reduced. The Pension Administration also received such information in 2018, but failed to ascertain whether the allowance should be reduced.
-  **Tax deduction from pensioners who did not file a Form 101** – the audit found that the Pension Administration is not deducting maximum tax pursuant to the Income Tax Regulations from the allowances of pensioners who did not file a Form 101, although they were asked to do so. A calculation performed by the audit team found that maximum tax at the inclusive total of ILS 30 million should have been deducted from the allowances of 950 pensioners who had an additional source of income in 2017; only ILS 6 million were actually deducted. It is emphasized that a portion of the allowance is tax exempt and the maximum tax rate is not deducted from it, and therefore, the tax that should have been received is less than ILS 30 million.
-  **Control over allowance payments** – the Pension Administration is not taking measures to ensure that the bank account number to which it is transferring the allowance indeed belongs to the pensioner according to Bank of Israel records, and to prevent embezzlement by its employees. It was also found that deviations reports and change monitoring reports being generated by the professional department are being manually examined, which is unsatisfactory, considering the sheer volume of the examinations and the required accuracy and documentation.
-  **Allowance payments** – in 2019, the Pension Administration began a process of transitioning to a new wage system supplier. During an examination conducted by the Pension Administration during the transition, it found that in December 2019, it had overpaid allowances to 29,877 pensioners at the total of ILS 287,835, and had underpaid allowances to 76,102 pensioners at the total of ILS 259,018. The



calculation represents the monthly discrepancy between the wage systems. Errors in taxing the pensions were also discovered. It was found that 29 pensioners and surviving relatives who received a retirement allowance or a survivor allowance were undertaxed at the total of ILS 700,000.







- ❗ **Pensioners residing abroad** – the Pension Administration requires pensioners and surviving relatives who reside abroad for more than six months to forward Certificates of Life to it every six months in as a condition to the continuation of the allowance payments. It was found that the Pension Administration continued paying a retirement allowance to 177 pensioners and surviving relatives who resided abroad and did not issue Certificates of Life. Subsequent to the completion of the audit, the Pension Administration stopped paying allowances to 123 of the pensioners and surviving relatives.
- ❗ **Tax benefit by virtue of Amendment 190 to the Income Tax Ordinance** – the amendment prescribes that the pension exemption rate will gradually increase in four stages in 2012, 2016, 2020 and 2025, so that in 2025, the exemption rate will be 67% of the maximum qualifying allowance. It was found that only the stage one increased exemption was given to thousands of pensioners and that some of them had not received any of the exemption increases at all pursuant to Amendment 190. A class action was filed against the Israel Tax Authority and the Pension Administration with regard to Amendment 190 and its implementation, which is still pending, and expectations are that a settlement agreement will be formulated.
- ❗ **Implementation of a continuity of rights agreement with the Old Pension Funds** – 1,700 pensioners are receiving allowances according to the continuity agreement signed by the State and the Old Pension Funds. The Funds are calculating the maximum allowance according to 70% of the determining wage and not according to the determining wage for a full-time job, such that, if a pensioner accumulated entitlement of 70% from the State, the pension Funds are not transferring the funds that they accumulated in favor of the pensioner to the Pension Administration even if he/she was employed in a part-time job and actually, the rate of the allowance being paid to the pensioner from the State is lower than 70% of the determining wage for a full-time job.
- ❗ **Common law spouses** – a widow or widower of a pensioner who is receiving a survivor allowance and began living with a common law spouse loses his/her entitlement to the survivor allowance. In 2015, the Pension Administration wrote to more than 14,000 widows and widowers who are receiving a survivor allowance and asked them to declare whether they are living with anyone as a common law spouse. Only 70 surviving relatives responded to the Pension Administration's letter. The Pension Administration failed to pursue the clarification and handling process in relation to 66 of them, even though most of them had declared the existence of a common law spouse or there were indications attesting to this, and it also failed to take action to obtain answers from all those who did not respond to its letter. These surviving relatives continued receiving the allowance up to the audit completion date.

 **Implementation of section 32(e) of the Pension Law** – this section calls for a reduction of an allowance due to employment in the civil service simultaneously with employment in an organization whose pension fund is defined as a public fund. Section 32(e) was enacted back in the 1970s, but the Pension Administration decided to begin implementing it only in 2015, and up until then, allowances were overpaid. Up until the audit completion date, no directive, procedure or position paper regulating all implementation aspects was published, even though it involves complex issues.



Replacement of a wage system supplier – the Pension Administration switched to a new wage system supplier and estimates that it will achieve savings totaling about ILS 140 million during the ten years of the engagement and savings of an additional ILS 140 million if it exercises the option to extend the engagement for another ten years.

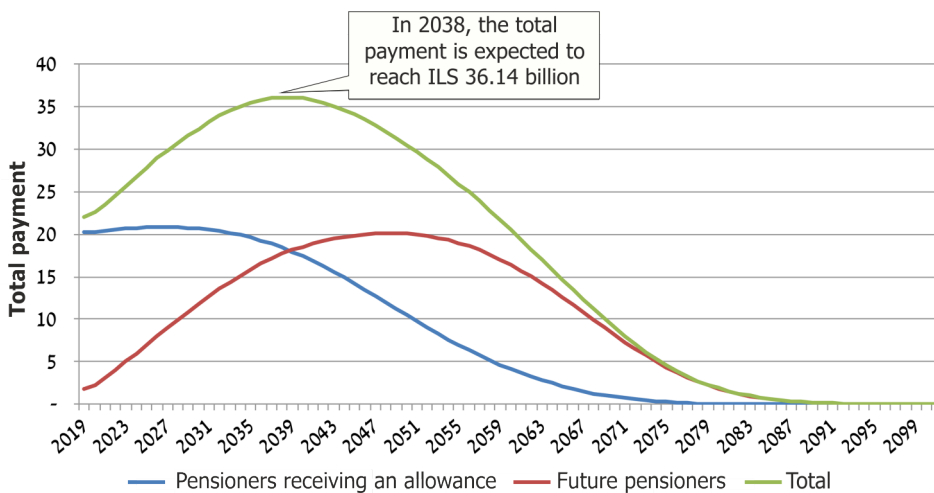
Key recommendations

-  It is recommended that the Pension Administration should examine the possibility of receiving online information on pensioners' income from the National Insurance Institute, from the Civil Service Commission and from the Wage Commissioner in the Ministry of Finance and should cross-check the information received in order to reduce allowances in the instances specified in sections 32 and 35 of the Pension Law.
-  The Pension Administration should take action pursuant to the Income Tax Regulations with regard to the deduction of tax from allowances of pensioners who failed to submit a Form 101, and should discuss this issue with the Israel Tax Authority in order to formulate a solution.
-  It is recommended that the Pension Administration should periodically review the effectiveness of the existing controls and consider ways to strengthen and mechanize them.
-  The Pension Administration should take action to pay the underpayments in full and to collect refunds of overpayments.
-  The Pension Administration should take action to regulate the payment of pensions pursuant to the continuity agreement and the ratios of participation between it and the Old Pension Funds in instances of pensioners who were employed in part-time jobs, and it should carry out account-settling accordingly with the Old Pension Funds.
-  The Pension Administration should take action to stop paying allowances to surviving relatives who have common law spouses and should consider the possibility of collecting overpayments that were paid. It is also recommended



that, considering the magnitude of the phenomenon and the expected impact on thousands of surviving relatives, and considering the data about termination of the allowance to only 20 surviving relatives who remarried in 2019, which totals about ILS 50 thousand per month, compared to the volume of monthly allowance payments to about 14,500 surviving relatives at the inclusive sum of about ILS 67 million (correct to December 2018), the Pension Administration should conduct comprehensive research in collaboration with relevant units in the Ministry of Finance, including with regard to the expected impact on the lifestyle of the surviving relatives who are receiving the allowance, and should discuss this with the Minister of Finance.

Expected budgetary pension payments to all State pensioners*



Source: the State of Israel's financial statements as on December 31, 2018 (unaudited).

* Pension payments to retired civil servants in government ministries, including payments to education system, healthcare system and judicial system pensioners who are being paid through the Pension Administration, and payments to retired police officers, prison guards and Security Establishment pensioners.



Summary

The Pension Administration is responsible for paying budgetary pensions to civil servants and to employees of additional defined organizations who have retired. The Pension Administration's budget comes from the State Treasury and it must use this budget according to principles of economy, while ensuring that it is paying pensions in compliance with the law. It must employ effective controls to ensure that it is not paying an allowance to anyone who is not entitled on the one hand and, on the other hand, to ensure that it is paying every pensioner or surviving relative the full allowance to which he or she is entitled according to his/her rights.

Considering the fact that the number of pensioners is expected to increase by 120,000 people within the coming years, it is recommended that the Pension Administration should improve the existing controls and consider defining new controls to the extent needed, with the objectives of safeguarding the State treasury and the pensioners' rights and of taking action to pay the underpayments in full and to collect refunds of the overpayments.

Considering the reported findings and considering their impact on the population of pensioners and on the State treasury, the Ministry of Finance should take action to rectify the deficiencies presented in this report.