



Office of the State Comptroller
Annual Report 71A | 2020

The Standards Institution of Israel – Financial Audit

Abstract

The Standards Institution of Israel – Financial Audit

Abstract

Background

The Standards Institution of Israel (the SII) is a public corporation established pursuant to the Standards Law, 5713 – 1953. The purposes of the SII are standardization and assuring adequate standards of product quality, whether by establishing standards or in any other manner. The SII's principal revenues are generated from its operation of standards compliance testing laboratories for thousands of types of products and from certification of manufacturing and construction processes in public and private companies according to local and international standards. The laboratories' spheres of activity include: construction, industry, agriculture, etc. Over the years, most of the SII's spheres of activity were opened for competition with private entities. Although the SII maintains exclusivity over the matter of standardization, there is a growing trend towards adopting international standards and customizing them for the Israeli economy. As a result of a comprehensive amendment to the Standards Law in 2016, the segment of standards compliance testing of imported products was opened to competition. Subsequently, in November 2017, the SII signed a collective labor agreement that includes the gradual three-stage retirement of 300 permanent employees from the SII by 2022. As a result of these measures, the SII's staff was reduced in 2019 from 1,000 employees to about 900 employees.

Key figures

ILS 417 billion

the SII's revenues in 2018

ILS 20 million

income after expenses (profit) in 2018

100

employees took early retirement from the SII in 2018. Another 200 employees are scheduled to retire by 2022

ILS 169 million

total retirement payments paid to employees in 2018, ILS 135 million of which were financed by the Ministry of Finance

ILS 110 million

balance of prepaid income (commitments) in 2018

ILS 20 million

balance of customers with a credit balance (commitments) in 2018


ILS 270 million

the SII's accumulated losses from units in its construction division over the last decade

ILS 13.8 million


balance of lawsuits against the SII in the 2018 financial statements. The provision in the 2018 financial statements was ILS 2.2 million


Audit actions


 From January to March 2020, the Office of the State Comptroller conducted an audit of financial matters relating to the Standards Institution of Israel. The audit focused on the following topics: the presentation of the financial statements, operating segments, analyses of material items in the statement of financial position and in the statement of profit and loss; financial and economic ratios; the work of the independent auditor; and corporate governance issues. The audit was conducted in the Standards Institution of Israel, in the Ministry of Economy and Industry (the Ministry of Economy) and in the Ministry of Finance. Supplementary audits were conducted in the independent auditor's office.


Key findings



 **Prepaid income for testing of imported products** – in the SII's industrial division, the balance of prepaid income for testing of imported products in 2017 was estimated at a minimum of ILS 15 million; this balance derives from the SII's commitments to conduct tests on imported products in instances when importers are allowed to release products from customs without testing, contingent upon the importers' undertakings to have the products tested later. Examinations conducted with authorities in the SII and in the Ministry of Economy gave rise to a concern of untested products, including products that could jeopardize human lives, such as flammable costumes and unsafe toys.




 **Prepaid income** – The SII's 2018 annual financial statements show approximately ILS 110 million in unearned (prepaid) income. This sum represents orders for service that have been paid for and not yet performed. Part of this amount relates to current operations, part is associated with delays in providing service, while the balance is for work that clearly was not performed.

 **Customers with a credit balance** – the SII's financial data correct to November 2019 contain customer credit balances at the volume of about ILS 27 million. At issue are balances that the SII decided should be refunded to customers but has not implemented his decision. The older the credit balances are, the harder it is for the SII to locate the customers and issue the refund. The SII could be exposed to a class action suit as a result of its failure to issue the refunds to its customers.

 **Reporting of operating segments** – the SII is not including information regarding segments' activity in its financial statements. Several profitable divisions in the SII are subsidizing other divisions' losses. The SII shows excess profitability in every segment in which the SII has a monopoly.

 **Assuring the accuracy of the financial statements and the effectiveness of the internal control** – senior officers of the SII are not signing declarations about the

accuracy of the data in the financial statements and about the effectiveness of the internal control. The SII, through its independent auditor, is not performing a thorough examination of the effectiveness of the internal control.


-  **Cumulative loss of two departments in the construction division** – the construction department and the land department have lost of about ILS 20 million on average per annum over the last decade and their cumulative losses totaled ILS 270 million in 2018. An internal audit report written in 2018 found that price quotes to customers in the construction division often cover the direct costs (based on the current pricing) but are insufficient to cover the indirect costs.
-  **Utilization of the SII's office space** – although 60 employees of the SII's Tel-Aviv branch either took early retirement or were reassigned to other branches (about 7% of the branch's employees), the branch's office space was not downsized.
-  **Net negative investment in fixed assets** – the SII's investments in fixed assets, after deducting depreciation expenses for 2016 – 2018 resulted in a negative investment. This fact indicates that the SII is underinvesting in fixed assets. If the SII maintains this policy, the testing equipment in its laboratories will become outdated, causing a decline in the professional standards of its services and in its capacity to compete against other service-providers.








Improvement in the SII's financial ratios – the SII's operating profit, equity ratio and EBITDA improved in 2016 – 2018.

Retirement program – in January 2018, an employee retirement program was launched, and 96 employees retired by the end of 2018. The retirement program was financed mainly by the Ministry of Finance and contributed to the SII's profitability.

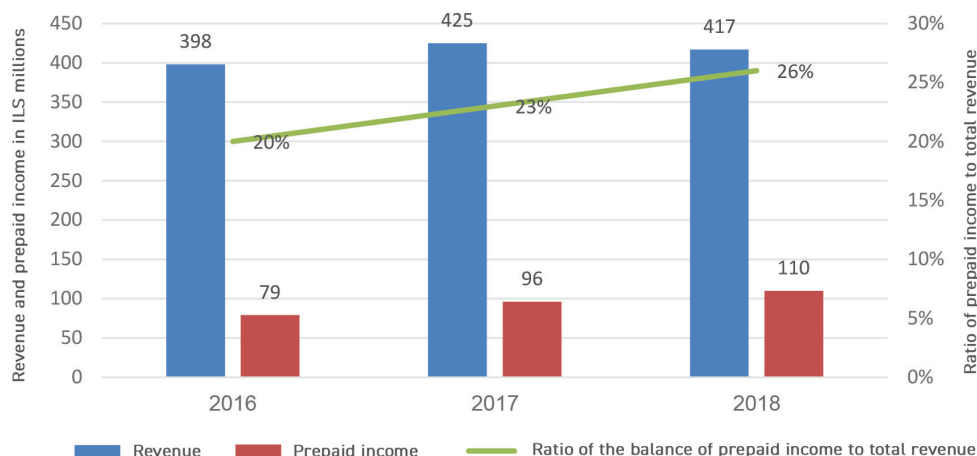
Key recommendations

-  The SII should consider the possibility of conducting tests on products and services for which payment has been received, but the products or services have still not been tested, particularly in relation to products and services that could jeopardize human lives. It is also recommended that the Ministry of Economy should examine those instances in which importers abused the conditional approvals in order to evade testing and should formulate procedures for issuing conditional approvals to release goods that are augmented by mechanisms to detect suspected devious intentions (profiling).

-  It is recommended that the SII should complete a work plan designed to reduce the customer credit balances and, in instances when the SII did not conduct the tests that it committed to conduct, it should ascertain whether it is required to return the funds to its customers.
-  It is recommended that SII's governing board and management should convene annual meetings to discuss the results of the SII's various operating segments, focusing on the construction division's losses, including the division's pricing, and on other unprofitable divisions, and should consider formulating a streamlining program for its continuing format of operation, particularly the operating efficiency of the construction division.
-  It is recommended that the SII should consider attaching declarations of its senior officers to its financial statements regarding the accuracy of the data in the financial statements and the effectiveness of the internal control. The SII should thoroughly examine the effectiveness of the internal control through its independent auditor. It is also recommended that the SII should examine, in coordination with the Ministry of Economy, a format for publishing its financial statements on the SII's website.
-  Considering the high cost of the early retirement program, which was largely financed by the Ministry of Finance, it is recommended that the Ministry of Finance and the SII should perform analyses and draw conclusions, with the aim of examining the success of the reform that opened the testing of imported products to competition and its effects on the SII's financial position.
-  It is recommended that the SII's management should periodically review the insurance coverage for the various lawsuits being filed against it, and should analyze and draw conclusions from the various lawsuits, particularly in relation to claims for damages.



Revenue, prepaid income (in ILS millions) and the ratio of prepaid income to total revenue



According to the SII's financial statements, processed by the Office of the State Comptroller.

Summary

The Standards Institution of Israel is a public corporation of economic importance to the State, which conducts tests for the primary purpose of safeguarding the public's health and wellbeing. The SII's objective is standardization, quality and safety.

The audit findings indicate that some of the SII's financial ratios have improved. In 2016 – 2018, the operating profit ratio (inter alia, due to employee retirements), EBITDA, current ratio and equity ratio showed improvement. On the other hand, the days of customer credit ratio deteriorated in 2016 – 2018 and the SII recorded negative net investments in fixed assets, inter alia, due to non-utilization of the investment budget. A cumulative material lag in investments could later have an adverse impact on the SII's development and innovation.