



State Comptroller of Israel | Annual Report 71C | 2021

Ministry of Finance

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# **The State of Israel's Financial Statements as of 31.12.2019 and its Long-Term Liabilities**





## The State of Israel's Financial Statements as of 31.12.2019 and its Long-term Liabilities

### Background

The State's financial statements present, inter alia, the extent of the government's long-term liabilities, and emphasize particular financial risks that are not included in the State's budget, which is managed on a cash basis. The State of Israel has a very large amount of long-term liabilities, mainly the liabilities of the National Insurance Institute (the NII), whose financial data are consolidated in the State's financial statements, and the liability for civil servants' budgetary pension.

Section 12 of the State Comptroller's Law of 1958 [Consolidated Version] prescribes that the Minister of Finance shall issue an annual "comprehensive report of the State's income and expenses during that year" to the State Comptroller. It must be submitted by a date to be specified by the State Comptroller, but no later than six months after the end of the State's fiscal year. The Minister of Finance shall issue a "statement regarding the balance of the State's rights and obligations as of the last day of the fiscal year, accompanied by any document that the State Comptroller might require to verify the statement of financial balance" by the date to be specified by the State Comptroller, but no later than nine months after the end of the State's fiscal year. The State's financial statements as of 31.12.2019 were submitted to the State Comptroller and were published in September 2020.



## Key figures

**NIS 2,920 billion**

The State's total liabilities as of 31.12.2019 – approximately 14% higher than in 2018.

**NIS 794 billion**

The State's net liability for budgetary pension on 31.12.2019 – approximately 27% of the State's total liabilities.

**NIS 887 billion**

The National Insurance Institute's total liability to insureds as of 31.12.2019 – approximately 30% of the State's total liabilities.

**NIS 2,294.7 billion**

The State's cumulative accounting deficit on 31.12.2019 – NIS 184.6 billion of which are the accounting deficit for 2019.

**59%**

The ratio of the State's liabilities for employee rights out of GDP for 2019, compared to the ratios in the United States, Australia and New Zealand (9%–24%).

**2044**

The expected year when the National Insurance Institute's surplus fund will have a net zero balance (according to the NII's assessment).

## Audit actions








From April to November 2020, the Office of the State Comptroller examined, from an accounting and actuarial perspective, the mode of presentation and recording of the material long-term liabilities stated in the Israeli government's financial statements. The audit was conducted in the Accountant-General's Department in the Ministry of Finance (including in the Salary, Benefits and Retirement Division: the Salary Division) and in the National Insurance Institute. Supplementary audits were conducted in the Bank of Israel and in Wage and Employment Agreements Department of the Ministry of Finance.

## Key findings



**The State's liabilities in its financial statements** – The examination of the financial statements as on 31.12.2019 found that the State's liabilities at the end of 2019 totaled NIS 2,920 billion, compared to NIS 2,562 billion at the end of 2018 – about a 14% increase. The majority of the increase derived from an increase of about NIS 314 billion in the item liability for employee rights and from the increase in the item "reserves for insured events," which are affected, inter alia, by actuarial calculations.



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**Accompaniment of an actuary in the decision making process** – Generally, actuarial accompaniment is not a part of material processes having a significant impact on the State's budget or on the amount of the government's liabilities. For example, an actuarial assessment was not provided in relation to decisions having a significant impact on the NII's financial resilience, in relation to percentage increases for the budgetary pension that the IDF's Chief of Staff approves for IDF retirees, or when employment agreements are signed in the public sector.
  
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**Liabilities in respect of other long-term benefits** – During the consolidation of the financial statements of government entities, the chief accountant consolidates government ministries that calculate provisions for employee rights not on an actuarial basis together with other government entities whose calculations are on an actuarial basis. The use of a non-uniform accounting policy could lead to an inconsistent presentation of data in the financial statements, which makes it difficult to analyze them and does not enable comparisons to be made between the said entities' data.
  
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**The State's liability for a budgetary pension** – The increase in the State's balance sheet liability for the payment of budgetary pensions over the last decade totaled approximately NIS 270 billion. In 2018–2019, the rate of the increase in the balance sheet liability was approximately 23%. The audit found that the controls performed on the actuarial calculation by the Ministry of Finance's actuarial consultant are based on an actuarial calculation performed on a sampling basis only and that the consultant does not sign declarations attesting to the adequacy of the data or to the performance of such controls. Deficiencies were also found in the basic assumptions about the budgetary pension that were used during the actuarial calculation, including in relation to adjustments to the mortality tables that were used. Employee seniority was not addressed as a factor affecting the probability that the employee will receive a pay raise. Deficiencies were also found in the assumptions about employee retirement, including early retirement, employee resignations and freezes on rights.
  
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**Sensitivity analyses of the State's liability for budgetary pensions** – The State's financial statements do not include sensitivity analyses, notwithstanding the provisions of the International Public Sector Accounting Standards. The sensitivity analyses performed by the Office of the State Comptroller indicate that the basic assumptions underlying the actuarial calculation have a substantive impact on the amount of the State's liability for budgetary pensions. For example, a 1% increase in the interest rate would result in approximately a 14.6% reduction in the amount of the liability.
  
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**The National Insurance Institute's accounting deficit** – The NII's accumulated deficit as on December 31, 2019 is NIS 586 billion, which derives mainly from the NII's liabilities for insureds' accumulated future as of the financial statements' preparation date.



**The National Insurance Institute's surpluses for funding pensions** – According to the NII's complete actuarial report in 2044, the NII will not have any surpluses left to cover its deficit. An initial analysis performed by the NII's actuary to examine the impact of the covid-19 pandemic found that the depletion date of the funds will be about a year and a half earlier, at the beginning of 2043 (according to the optimistic scenario).



**The National Insurance Institute's funds** – The NII's funds, which represent its liabilities to the public, increased between 2014 and 2019 from NIS 522 billion to NIS 887 billion; i.e., an increase of about 70%. Although the child allowance is paid for 18 years for every child, the funds included only the following annuity items: old age and survivors; general disabilities; occupational disabilities and supportive care. Consequently, the State's financial statements do not include the NII's liability for child allowances.



**Sensitivity analysis of the impact of a change in the retirement age for women on the National Insurance Institute's actuarial liability** – Notwithstanding the potential major implications of a potential decision about raising the retirement age for women, the NII failed to perform an actuarial calculation of the alternatives. The audit found no updated calculation of the impact of a change in the retirement age on the NII's equilibrium. A sensitivity analysis performed by an NII actuary at the request of the Office of the State Comptroller in this regard found that increasing the retirement age for women to age 64 would defer the depletion date of the NII's reserve for an additional two to three years after 2044.



**Updating of the mortality tables** – In 2019, the Ministry of Finance updated the mortality assumptions of people insured under a budgetary pension and adjusted them to the tables published by the Capital Market, Insurance and Savings Authority.

## Key recommendations



It is recommended that an actuary advise the government on material processes having an impact on the State's budget and on the government's long-term liabilities, so that decision-makers and policy-setters will have an empirical base for reaching future decisions having broad impacts on the State of Israel's fiscal policy. Considering the substantial monetary volume of the State's liabilities, as reported in the financial statements, it is recommended that the chief accountant in the Ministry of Finance consider appointing a government actuary.



It is recommended that the Accountant-General, in collaboration with the Minister of Finance, present the financial statements to the government and to the Knesset annually, upon their publication, so that the information contained in them is presented in an



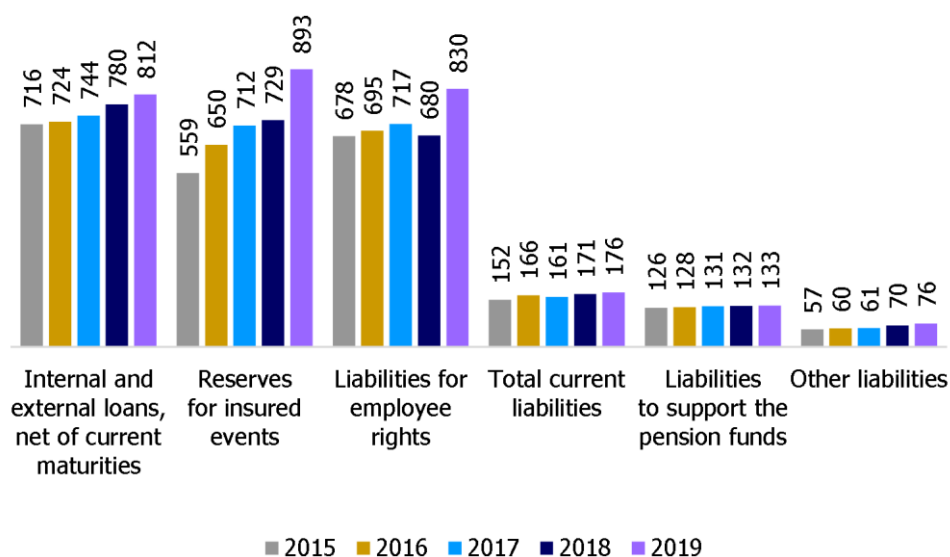
orderly and comprehensive manner to the decision-makers. This course of action may contribute to enhancing the government's accountability, to improve the government's use of public resources made available to it, and to provide a platform for discussing the assets and liabilities (particularly the long-term liabilities) and for analyzing the State's short-term and long-term economic challenges.

- 💡 It is recommended that the chief accountant complete the establishment of a government-level computerized system for all entities that are consolidated in the financial statements, so that it will be possible to present all of the entities' data uniformly based on actuarial assessments.
- 💡 Considering the significant burden on the State's budget due to the payment of budgetary pensions, it is recommended that the Accountant-General's Department analyze the impact of the contribution rates of employees insured under the budgetary pension on the State's actuarial liability for the payment of the budgetary pensions, including calculations of possible alternatives for such contributions. It is also recommended that the Ministry of Finance advance the government resolutions of 2005 and 2015 on the subject of increasing the deduction rate from the wages of employees and officers with a budgetary pension, after examining the various alternatives.
- 💡 It is recommended that the Accountant-General add sensitivity analyses to the financial statements being published annually, as is required in IPSAS 39, of the assumptions underlying the calculation of the State's material long-term liability items, considering the considerable repercussions that potential changes in the volume of these liabilities would have and their impact on optimal preparedness for the future.
- 💡 It is recommended that the Accountant-General examine the presentation of the inclusive annual expenditure actually being paid to all recipients of budgetary pensions and add a note to the financial statements about the budgetary performance included in the State's financial statements or, alternatively, in the section "additional information" that accompanies the financial statements. The addition of this information should clearly explain to the readers of the financial statements the total inclusive annual expenditure paid to recipients of budgetary pensions, including pensioners of the Defense Establishment, the Israel Police and the Israel Prison Service.
- 💡 The children's allowances that the National Insurance Institute pays which, as of 2020, total approximately NIS 8 billion, have similar characteristics as those of disability, old age and supportive care allowances, since they are allowances that are paid over many years. Therefore, it is recommended that the NII re-examine the accounting policy that it is applying in relation to the performance of an actuarial calculation of the NII's liability for children's allowances, and should apply a uniform accounting policy.
- 💡 Considering the continuous discussions about raising the retirement age for women, it is recommended that the NII periodically analyze the alternatives raised for discussion with



regard to deferment of the payment of old-age pensions to a segment of the population that could have a direct impact on the NII. The Ministry of Finance, in collaboration with the Ministry of Labor, Welfare and Social Services and with the NII, should examine the repercussions of the various alternatives for raising the retirement age for women on the NII's financial resilience. The examination should be based on the analyses performed by the NII's actuary and by the research unit, as well as the social repercussions of such a course of action.

### Segmentation of the State's Liabilities 2015–2019 (in NIS billions)



According to the financial statements for 2015–2019, processed by the Office of the State Comptroller.





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## Summary

The State's financial statements reflect its financial situation. The long-term liabilities disclosed in the financial statements have significant financial implications on the State's financial management and they therefore require the performance of actuarial calculations based on calculation methodologies and current data and basic assumptions. The audit found that the State's long-term liabilities are not being optimally analyzed using actuarial calculations. Inter alia, the audit found that there is no government actuary who advises the State on actuarial aspects before decisions with long-term budgetary implications are made. It is recommended that the Ministry of Finance and relevant bodies take action to rectify the deficiencies and consider the recommendations proposed in this report.

