



Report of the State Comptroller of Israel |
November 2022

Israel Electric Company Ltd.

Streamlining at the Israel Electric Company Ltd.



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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.

