



Report of the State Comptroller of Israel |
November 2022

Ayalon Highways Ltd.

Ayalon Highways Ltd. – Reorganization and Financial Aspects



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Background


Ayalon Highways Ltd. (AH or the Company) is a government company that serves mainly as an executive arm of the Ministry of Transportation and Road Safety (Ministry of Transportation or MOT). Until 2016, the Company was jointly owned by the Israeli government and the Tel Aviv-Jaffa municipality; That year, the Company became wholly owned by the state, and in 2018 the Company began a reorganization process. In 2017 and 2020, two government resolutions were adopted, redefining its goals and expanding its areas of operation. Among its goals: planning urban and metropolitan transportation projects and their execution; Creating and managing the transportation master plan team; Management, initiation, and development of technological projects in transportation; Planning, development, maintenance, and traffic management of roads and public transportation facilities. The MOT finances most projects the Company is responsible for and supervises its activities. The Government Companies Authority and the Ministry of Finance also monitor the Company's activities.



Key Figures





97%	NIS 1.296 billion	61%	NIS 7.6 billion
of the Company's revenues in 2021 were from the MOT	the company revenues in 2020; 94% of them from project management	the average annual growth rate of the Company's activity in 2017–2020	the order backlog at the end of 2020
5.7%	175	1.16	68%
the rate of administrative and general expenses in relation to the cost of sales. The target set for the Company by the Government Companies Authority: 4%	the Company's employees in 2020, compared to 71 in 2017	the current ratio in the 2020 balance sheet	of the Company's invoices paid to its suppliers and reviewed by the MOT in 2021 – about NIS 555 million, deviated from the Payment Ethics Law rules

Audit Actions

-  From September 2021 to March 2022, the State Comptroller Office examined the Company's reorganization procedure, its financial data, its work processes regarding project management, and the Company's control processes. The financial data and quantitative information in the financial statements for 2020 included in the audit are correct as of the end of 2020 (unless otherwise stated in the body of the report). The audit was conducted at the AH and the Ministry of Transportation. Completion audits were conducted at the Government Companies Authority and the Ministry of Finance.





Key Findings


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Determining the Areas of Operation of the Government Infrastructure Companies by the MOT – the audit raised that the Ministry of Transportation did not formulate a policy document based on systemic, strategic work indicating the advantages and disadvantages of the various dividing options of the operation areas between the infrastructure companies. Therefore, the government resolutions determined the goals of the infrastructure companies without a coherent strategy. In practice, the resolutions were based upon the situation that prevailed then, without guidelines for distributing the projects and works between the companies. The lack of a clear policy also causes uncertainty to the infrastructure companies and might make it difficult for them to plan their activity optimally.
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The Framework Agreement Between the State and the Company – as of the audit completion – more than five years after the separation of the holdings in AH was completed, and since the government wholly owns the Company – no framework agreement has been signed between it and the government. Government resolutions stipulate that the Company's activities will be based on agreements signed between the state and the Company, anchoring various issues of the delivery of works, the Company's conduct vis-a-vis the government, and its supervision and control. However, during these years, the MOT handed over many assignments and projects to the Company without an agreement and an orderly procedure for engagement with a tender exemption, in contravention of the Mandatory Tenders Regulations.
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Appointment of Directors – the audit found that for a year and a half (except for two months), the composition of the board of directors was lacking, according to the Company's statute, and consisted of two to four members instead of five to nine members as stipulated in the Company's statute. Moreover, the board meetings had no legal quorum for two months. As of the audit completion, the board of directors is operating with a wanting panel – with only four members – which may affect the Company's proper management.
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The Company's Responsibility and Powers – promoting urban projects efficiently and minimizing the adverse affect on the city's day-to-day life require close coordination between AH and the local authorities. As the Company does not have the required powers to promote the projects, including the powers of a signage authority, the progress of the projects depends on the local authorities consent, whose interests sometimes do not coincide with the interests underlying the promotion of the projects. This is especially material when projects pass within the jurisdiction of several authorities, as in the "Fast to the City" (Mahir la'ir) Project. In some projects, due to their planning





complexity and the long time required to complete them, the local authorities changed their position and demanded changes in the planning.

 **Metropolitan Transportation Authorities** – in the absence of metropolitan transportation authorities, the Company fulfills some of the roles that these authorities were supposed to fulfill, including establishing and operating metropolitan centers for traffic management and control. However, without regulation anchoring the powers of the body that manages the centers, AH should reach mutual agreements with each local authority separately. Thus, the operation of the metropolitan command and control center established in Tel Aviv-Yafo is delayed.

 **The Company's Level of Liquidity** – by the analysis of the Company's financial statements, alongside the accelerated growth in the Company's activity, its level of liquidity is decreasing. The liquidity indices indicate that the Company's means to finance its activities are decreasing, and the importance of timing the receipt of funds from the MOT for payments to its suppliers and the Ministry's approval of the entire payments is increasing. It should be noted that according to the Company's risk survey, the Company rated its dependence on government decisions and regulatory factors as a high-level risk (ranking 5 out of 5) with a high degree of probability (ranking 4 out of 5).

 **Claims Against the Company** – the Company's provisions for claims in the balance sheet at the end of 2020 were about NIS 3.7 million. At the same time, the scope of claims was NIS 594 million, for which no provision was made, most of them due to the decrease in the value of assets under Section 197 of the Planning and Building Law, 1965. By the company's notes in its financial statements, based on experience and its legal counsel's opinion, it has no financial exposure regarding claims for which it has not made a provision due to small chances assessment of the claims or due to their preliminary stages.

 **The Company's Payment Ethics** – under the Payment Ethics Law, the Company should pay its suppliers in engagements other than construction engineering works within 30 or 45 days and in construction engineering works – within 70 or 85 days. 68% of the invoices paid by the Company to its suppliers and examined by the MOT in 2021, about NIS 555 million, deviated from the Payment Ethics Law. Furthermore, about 28% of the overdue payments were transferred to suppliers with a delay of over 50 days.

 **Budgeting of Projects and Their Management** – in examining projects over NIS 30 million, it was found that the costs determined in the tender were 3% to 27% lower than the estimated contractual costs before the publication of the tender. This prevails in most of the AH projects examined in the audit (64 out of 69), particularly in the larger ones, although the audit also found the opposite. The budget allocated by the MOT for the project's execution is determined before the publication of the tender, according to the RFT report, and it is not updated afterward according to the cost specified in the tender. This allows the Company great flexibility with project changes, sometimes



resulting of complexity and great management uncertainty. However, the difference in costs may fund increased expenditure on the project, with little supervision and control, since the additional expense does not exceed the budget framework. In all the projects examined at over NIS 30 million, the contract works cost increased during the project execution compared to the cost stipulated in the contractor agreement.



Project Management System – it was found that the project information appears in the Company's various execution divisions. Still, no single information system contains all the project data and no uniform format for saving the information and generating reports.



Controls on the Company by the Ministry of Transportation – there is a shortage of employees in the Infrastructure Administration of the MOT, and four out of six positions are not staffed, which may affect the processes of supervision and control of government infrastructure companies, including AH. Deficiencies were found in the MOT controls of AH's compliance with the cash flow forecast, the projects' adherence to the budget and schedules, and the documentation of the changes in the budget and schedules. Moreover, MOT has no suitable computer system to efficiently monitor the project's progress, presenting the changes and their causes in the schedules, budget, and contents throughout its life and obtaining a comprehensive situation report on the budget transferred to the Company.










The Company's Reorganization – the Company began to reorganize in 2018. By the audit end, it had, among other things, made a fundamental change in the organizational structure, formulated and implemented a new system of procedures, significantly increased its workforce, implemented new computer systems, drew conclusions from previous audit reports, implemented control processes, conducted a risk survey, formulated a strategic plan and more. All this while significantly increasing the scope of activities and expanding and improving the Company's performance capacity.

Coordination with Other Infrastructure Companies and Government Bodies – the State Comptroller's Office commends the establishment of the infrastructure coordination system by the MOT, the Prime Minister's Office, and the Ministry of Finance to facilitate the locating of infrastructure for promoting transportation projects and the coordination request process. However, there are still many difficulties following the submission of coordination requests when determining the content of the works, the time of their execution, and the identity of those executing them and during the actual execution of the works. For example, delays in the coordination and execution of infrastructure relocation work carried out by other infrastructure companies and reduced working hours in the areas of the railways to reduce the harm to the train's activity.

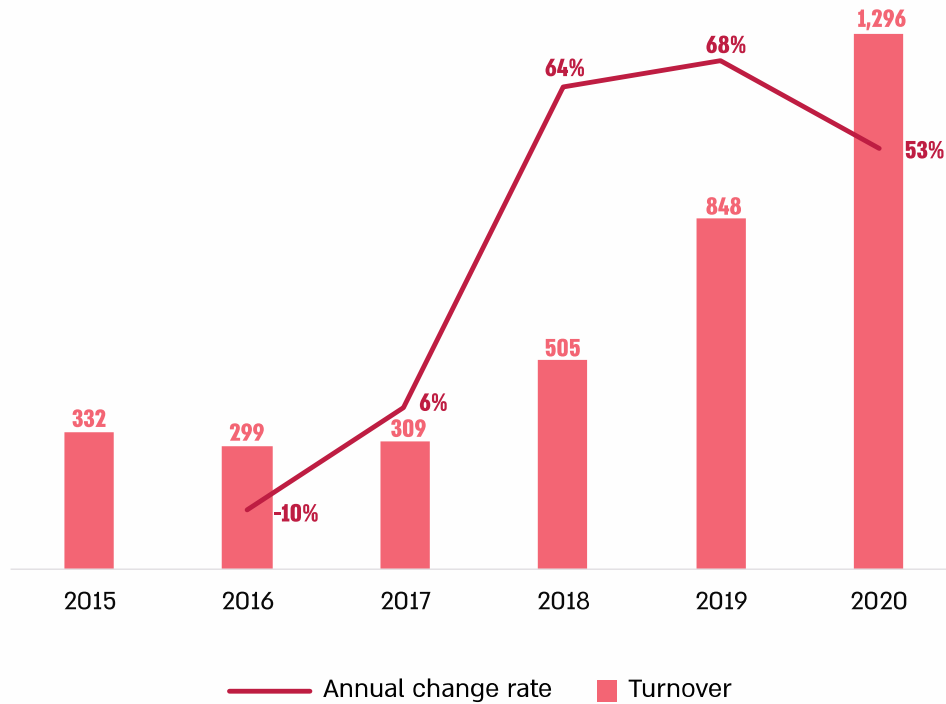


Key Recommendations

-  The MOT and AH, in coordination with the Government Companies Authority and the Ministry of Finance, should sign a framework agreement between the state and the Company to regulate the joint activity under the government's resolutions and the Mandatory Tenders Regulations.
-  The Ministers of Transportation and Finance should appoint directors under the Government Companies Law for the Company's proper corporate governance.
-  It is recommended that the Ministries of Transportation and Finance establish metropolitan transportation authorities and, until then, use alternatives as interim solutions to remove the barriers to the Company's activities and balance the metropolitan interests with the local ones.
-  It is recommended that the MOT continue to examine and implement ways to ease transportation infrastructure companies to enlist the cooperation required for engineering coordination and facilitate the work processes. For example, collaborating with relevant government bodies and regulators, and create a uniform version of the agreements, commitments, and insurance requirements.
-  The Company and the MOT should examine the reasons for deviation from the Payment Ethics Law, comply with the law's requirements, and fully cooperate in shortening the times for approving payments and their handling.
-  It is recommended that the MOT implement a comprehensive information system for managing projects in the transportation infrastructure companies in general and AH in particular and that the infrastructure companies cooperate with it. It is also recommended to consider integrating into the system an online module for reports to the MOT in a uniform format for all infrastructure companies.
-  It is recommended that the Ministry of Finance and the MOT adjust the commitments for the project's execution, considering the results of the tenders. It is also recommended to consider a mechanism for increasing expenditure beyond the contractual agreement. If so, it is recommended that the Ministry of Finance and the MOT implement a flexible and controlled mechanism to allocate the budget according to project risk level. For example, through the budgeting of contingencies, for which regular supervision and control mechanisms have been defined, or through the budgeting of a designated reserve.



AH's Turnover, 2015–2020 (in NIS millions)*



According to the Company's financial statements data, it is processed by the State Comptroller's Office.

- * In the financial statements for 2018, the Company adopted the IFRS standards for the first time. The reporting date for the transition to this standard was January 1, 2017. Therefore, the numerical comparison of 2015 and 2016 to the following years is inaccurate. To counteract the effect of the change in the reporting method on the annual change rates, the change rates were calculated each year compared to the previous one based on the data in the same financial statement.



Summary

Since AH's reorganization began, there has been a considerable increase in its activities scope, its areas of activity have been expanded, and it has made substantial changes in its organizational structure and work methods. The audit raised that the regulation of the Company's activities vis-à-vis the state, particularly the MOT, has not been completed since it became a company wholly owned by the government. It was found that the Company has no project management system nor uniform format for information saving. In addition, deficiencies were found in the MOT controls. It was also found that the Company sometimes finds it difficult to cooperate with local authorities, other infrastructure companies, and government bodies for coordinating infrastructures. It is recommended that the Ministries of Transportation and Finance, and the Government Companies Authority regulate AH's activities and its powers and improve the monitoring, supervision, and control of its functioning. It is also recommended that the Company continue to develop its capabilities in the areas under its purview.