



State Comptroller of Israel | Local Government
Audit Report | 2023

Financial Audit

**Financial Audit in
Financially Sound
Local Authorities**



Financial Audit in Financially Sound Local Authorities

Background

Israel is a highly centralized country regarding the local government-central government relationship, particularly in the financial field. Over the last decades, there has been a growing discourse around the world calling for decentralization and greater independence for local government. In 2014, Amendment 135 to the Municipalities Ordinance [New Version] (the Municipalities Ordinance or the Ordinance) led to the orderly decentralization of powers to local authorities. According to amendment 135, the Minister of Interior will declare a local authority as financially sound if it has met the financial conditions stipulated by law and properly manages its budget and affairs according to all the law provisions (financially sound local authority). Declaring a local authority as financially sound exempts it from some of the law requirements that generally obligate local authorities, including the requirement to obtain the Ministry of Interior approvals for actions such as allocating a budget, signing contracts to grant concessions, executing land transactions, writing off debts and employing through personal contracts. On the other hand, authorities declared financially sound are denied the right to receive grants from the Gaps Reduction Fund, and authorities adjacent to Ben-Gurion Airport that have been declared financially sound are also denied further funds.



Key Figures

36	3.1 million (33.7%)	21	71.4%
local authorities out of 256 are declared financially sound as of April 2023	residents live in financially sound local authorities (according to the Central Bureau of Statistics for the end of 2020)	financially sound local authorities (out of 36) are in socio-economic index clusters of 7–10, 15 are in clusters 4–7, and none are in clusters 1–3	the average rate of the financially sound authorities' Own Income in 2019. 26% higher (in percentage points) than the average rate in the non-financially sound authorities – 45.4%
0	194	NIS 5,600	4
the number of non-Jewish local authorities among financially sound ones	local authorities received a balancing grant in 2019 and, thus, could not be declared financially sound	the average Own Income per resident in 2019 in a financially sound authority, as opposed to a non-financially sound authority – NIS 2,524	procedures for the declaring and revoking by the Ministers of Interior since 2014 (out of 9 that were supposed to be carried out)



Audit Actions

From May to December 2022, the State Comptroller's Office examined the Ministry of Interior mechanism to declare financially sound local authorities and revoke the declaration, as well as the mechanisms to examine the financial conduct of the authorities declared as such. The audit analyzed the local authorities' financial statements and detailed audit reports, conducted interviews, and reviewed correspondence and various documents. The audit also examined the financial data of all the financially sound authorities declared as such since 2014 and those whose declaration as financially sound was revoked. An in-depth audit was carried out in **Ashkelon, Holon, Haifa, and Kfar Saba**, in the **Tamar** Regional Council, and in **Even Yehuda** (the authorities that underwent an in-depth audit), as well as in the headquarters of the Ministry of Interior and four of its districts: South, Haifa, Center and Tel Aviv. A completion audit was conducted in Hadera and **Ra'anana**, the **Hof Hasharon** Regional Council, **Rosh Pina, Azor, and Kfar Shmaryahu**. The laters were selected while considering their municipal status, the Ministry of Interior's district they belong to; their socio-economic cluster; the peripheral cluster to which they are associated; and the number of residents living within their jurisdiction.

Key Findings



Own Income per Resident – the average Own Income per resident in 2019 in financially sound local authorities was NIS 3,078 (122%) higher than that of authorities not declared financially sound. Financially sound local authorities can invest a higher rate of their budget in services for their residents compared to other local authorities.

Expenditure per Resident for Local Services – in 2019, the average expenditure per resident for local services, such as sanitation services, city beautification, municipal supervision (enforcement), urban planning, guarding and security – services that considerably affect the quality of life of the residents in the private and public sphere – was NIS 1,706 in the financially sound local authorities – NIS 556 (48%) over those that were not declared financially sound (NIS 1,150).

Declaration and Revocation of Declaration Procedures – the Ministry of Interior, which is authorized by law to make decisions and manage the procedures examining the local authorities' compliance with the conditions for declaring them as financially sound authorities, did not formulate an orderly procedure, including timetables and areas of responsibility to manage the declaration mechanism. In addition, the procedures were



not conducted in a consistent, orderly, and transparent manner. Thus, out of the nine years since the amendment to the Municipalities Ordinance in March 2014, the Ministry of Interior has not completed the examination procedures within five years. Hence, local authorities that operated efficiently and appropriately and met the required conditions in the years when the declaration procedure was not completed did not benefit from the decentralization of powers accompanying the status of financially soundness during this period. Local authorities that did not meet the conditions and did not operate efficiently and properly continued to operate under reduced control, even though this could have jeopardized their stability.

 **The Financial Threshold Conditions and Good Governance Criteria for Declaring a Local Authority as Financially Sound** – it was raised that among the financial conditions for recognizing a financially sound authority, some constitute a challenge for most local authorities to meet, as of 2019 (the absence of a current deficit in the three previous years [58%] and a percentage of Own Income [77%]), including financially sound authorities. On the other hand, one condition most of the authorities met (cumulative deficit rate and credit balance [88%]) and another that almost all authorities met (loan repayment rate [99%]). One financial condition was increasingly met (minimum municipal property tax collection rate higher than 80%), and another became increasingly difficult to meet (minimum self-generated income rate of 62.5%). Deficiencies were also found in the Ministry of Interior's use of good governance criteria to formulate the Director General's determination whether the authority manages its budget or its affairs improperly and not according to the provisions of the law, preventing it from being declared a financially sound authority. It was raised that non-compliance of local authorities with the Ministry of Interior criteria for good governance did not lead to summons for hearing or revoking of declarations.

 **Non-receipt of a Balancing Grant as a Threshold Condition for Financially Sound Status** – this precondition prevented 194 local authorities (76%) that received a balancing grant in 2019 from receiving financially sound status and 11 of them were denied the possibility of being declared financially sound even though they received balancing grants at a rate of up to 2% of their income – a rate that does not indicate improper financial conduct or significant dependence on central government.

 **The Effect of Accounting Rules on the Rate of Own Income** – the accounting rules applicable to local authorities do not allow a comparison – regarding the rate of Own Income – between local authorities that operate recreational services through a municipal association and between authorities that operate these services themselves. Furthermore, due to the accounting rules that apply to local authorities, loan recycling carried out by a local authority reduces the rate of its Own Income.

 **The Control over the Conduct of the Financially Sound Authorities** – it was found that since the Ministry of Interior began decentralizing powers to financially sound local authorities, there is no systematic policy controlling their conduct. Deficiencies were



found in the six financially sound local authorities' self-auditing that underwent an in-depth audit. Thus, except for **Ashkelon**, deficiencies were found in the internal audit mechanism in **Holon, Haifa, Kfar Saba**, and **Even Yehuda** and in the **Tamar** Regional Council. Among these authorities, some council plenary did not approve their budget on the date set by law in 2017–2019 (**Holon** and **Haifa** in 2017 and 2019, **Kfar Saba** in 2018 and 2019, and **Even Yehuda** in 2019).



Consequences to the Local Authorities with Financially Sound Status – the audit raised that the local authorities only partially use the concessions they receive in the regulatory requirements from the Ministry of Interior, concessions intended to increase their independence in managing their affairs and to encourage local authorities to conduct themselves properly to benefit from the decentralization of powers. This partial use may be affected, among other things, by the characteristics of each authority and its needs. The audit also found that the declaration of local authorities as financially sound prevents them from receiving grants from the Gap Reduction Fund and prevents the financially sound authorities adjacent to the Ben Gurion Airport from receiving an additional distribution of funds, which may affect their degree of motivation to meet the conditions and criteria required to be declared financially sound.



Control Tools – the South, Haifa, Center, and Tel Aviv Districts of the Ministry of Interior have developed independent tools to monitor the conduct of the authorities declared financially sound in their area.

Discussing the Current Budget – **Holon, Haifa**, and **Kfar Saba** regularly held discussions on their budgets in 2017–2019.

Key Recommendations



It is recommended that the Ministry of Interior regulate the procedures for declaring and revoking the declaration of financially sound authorities while determining areas of responsibility and clear timetables. Among other things, it is recommended that the process begin every year with the publication of the audited reports and end with the publication of an up-to-date list of financially sound authorities within a reasonable period, in which the collected findings will be updated and faithfully reflect the state of the authorities. It is also recommended that the Ministry of Interior increase transparency and publish its decisions in hearings for financially sound authorities and the reasons for them. Transparent conduct will reveal, first and foremost, the conditions according to which a local authority can gain the status of financially soundness, increase the number of local authorities that will be declared financially sound, increase good governance among all local authorities, and correspondingly also the decentralization.



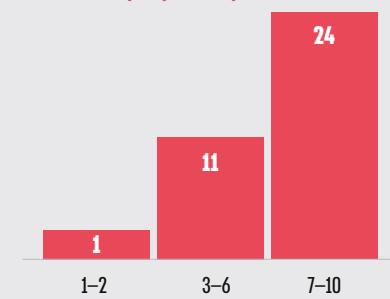
- 💡 It is recommended that the Ministry of Interior examine the financial threshold conditions and the ability to optimally reflect the financial soundness of the authorities so that the status is granted to all the authorities deserving of it. Furthermore, it is recommended that the Ministry of Interior consider adding criteria for examining the good governance of the authorities, thus incentivizing them to improve their work processes and the conduct of their internal mechanisms as much as possible.
- 💡 It is recommended that the Ministry of Interior consider amending the threshold conditions regarding the balancing grant – so that authorities entitled to a balancing grant at low rates compared to their income may be declared financially sound.
- 💡 It is recommended that the Ministry of Interior examine the accounting rules applicable to the local authorities for the uniform and equitable use of their Own Income index and to reliably reflect the financially soundness of the local authorities. Alternatively, it is proposed to publish adjustments to the criteria for eligibility to the status of a financially sound local authority, which will eliminate the gaps arising from the accounting rules.
- 💡 It is recommended that the Ministry of Interior regulate the control procedures over the financially sound authorities and include in the collection of information and data every year as part of the processes of declaring authorities as financially sound and the revoking of such declarations, the data of the audits to be conducted in the districts. The Ministry of Interior should also consider the opinions of the district supervisors.
- 💡 It is recommended that **Holon, Haifa, Kfar Saba, and Even Yehuda** approve the local authority's budget by its council at the beginning of the fiscal year, according to the provisions of the relevant law.
- 💡 It is recommended that the Ministry of Interior examine whether the decentralization of powers encourages local authorities to operate properly to gain said powers and if the decentralization of powers given to the financially sound local authorities should be expanded while orderly supervising their conduct in the decentralized areas. Furthermore, it is recommended that the Ministry of Interior and the Ministry of Finance examine the consequences of the distribution policy of the Gap Reduction Fund and the budget intended for the authorities adjacent to Ben Gurion Airport and its effect on the degree of motivation of local authorities to meet the conditions and criteria required to be declared as financially sound. It is also recommended to examine the link between the financially soundness of the local authorities and the rationale behind this distribution of funds. The examination above is critical as the local authority is not sovereign to decide whether it accepts the status of financially soundness or rejects it.



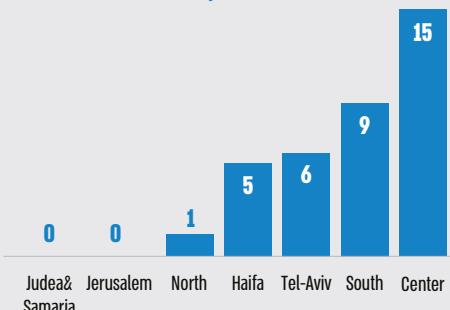
Main Characteristics of the Financially Sound Local Authorities, 2021



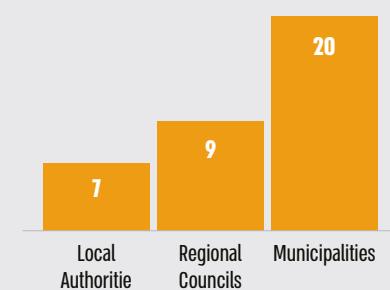
Breakdown of authorities declared as financially sound according to the peripherality index



Breakdown of authorities declared as financially sound according to the Ministry of Interior districts



Breakdown of authorities declared as financially sound according to municipal status



Breakdown of authorities declared as financially sound according to sector affiliation



Breakdown of authorities declared as financially sound according to sector affiliation

36

Jewish sector

0

Non-Jewish sector

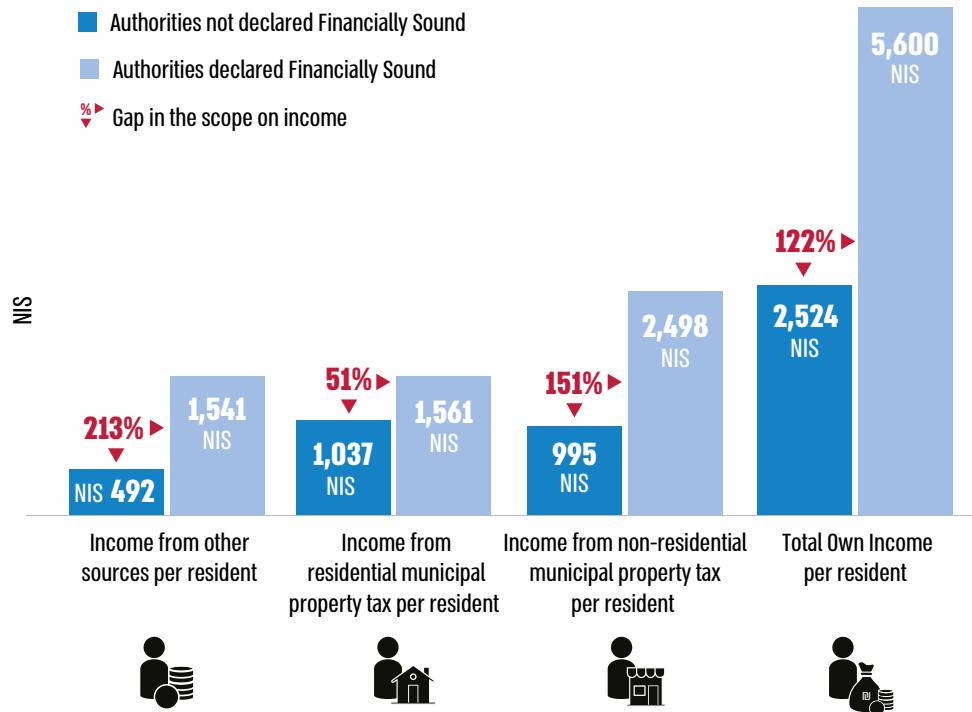


Comparison of local authorities in terms of their number, the number of residents and their income





The Average Own Income per Resident, by the Types of Income in Financially Sound Authorities and in Authorities not Declared Financially Sound, 2019



According to audited financial statements of the local authorities for 2019, processed by the State Comptroller's Office.



Summary

The amendment of the Municipalities Ordinance in 2014 was a turning point in the relations between local government and central government in Israel after forming the orderly process of decentralization of powers, which had until then been vested in the Ministry of Interior, and transferred to local authorities that managed their financial and administrative affairs properly. These were declared "financially sound authorities" and as of the audit time includes 36 local authorities populated with 3.12 million residents (33.7% of the country's residents), most of whom are characterized by high Own Income per resident.

It was found that the Ministry of Interior did not formulate an orderly procedure, including timetables and areas of responsibility to manage the mechanism for declaring financially sound local authorities. Out of the nine years since the amendment to the Municipal Ordinance came into force, the Ministry of Interior has not completed the examination procedures within five years. Examining the financial threshold conditions required for the declaration raised that there are financial conditions for recognition as a financially sound authority, but which most local authorities find challenging to meet, and the main condition among them is the rate of Own Income. The audit raised deficiencies in the Ministry of Interior use of good governance criteria for formulating the opinion of the Ministry's Director General before the declaration. Furthermore, deficiencies were found in the self-auditing of the authorities that underwent an in-depth audit of the internal audit mechanism and the approval of the current budget. The audit also found that the authorities only partially use the concessions they receive in the regulatory requirements from the Ministry of Interior. This use is influenced, among other things, by the characteristics and needs of each authority. It was also raised that the declaration of local authorities as financially sound prevents them from gaining specific government grants, which may affect their degree of motivation to meet the conditions and criteria required to be declared financially sound.

It is recommended that the Ministry of Interior rectify the deficiencies and examine the recommendations above in its actions to decentralize powers to local authorities – both in the decision-making process regarding which authorities will be decentralized and in the operation of a consistent and transparent mechanism, which includes a regulated control over the decentralized powers. Moreover, the local authorities found to have deficiencies in their conduct in this report must rectify them.

