Report of the State comptroller of Israel | January 2024

Israel Postal Company Ltd.

The Establishment of the Postal Campus and Property Management of the Israel Postal Company

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Background

The Israel Postal Company Ltd. is a government company exclusively owned by the State, which began operating in March 2006 under a license issued by the Postal Law, 1986. The Government Companies Authority supervises the Company's operations, and specific aspects of its activities are also subject to the supervision of the Ministry of Communications.

The Company's relocation to the Postal Campus in Modi'in was primarily due to the increase in online trade of items, which rendered the former sorting facility in Tel Aviv unsuitable for the evolving nature of postal operations for reasons of enhancing efficiency, better integration and communication between the headquarters and operations, as well as optimizing space utilization. In 2016–2017, the Postal Company established the online trade center in Modi'in, subsequently followed by the establishment of its headquarters and Postal Bank offices within the same complex, effectively making it the Postal Campus.

The Company established the Postal Campus in two phases:

- **Phase A:** In early 2017, the Company relocated its sorting operations from Jerusalem, Tel Aviv, and Haifa to the online trade center in the industrial area of Modi'in.

- **Phase B:** About four years later, during the first quarter of 2021, the Company relocated its offices and headquarters units from various locations across the country to the same complex in Modi'in, thus making the entire complex into the Postal Campus.

The Company owns over 300 real estate assets that must be managed while adhering to proper governance principles and according to cost-efficiency and efficiency criteria.

The Company has experienced significant financial deterioration in recent years, with a considerable reduction in the volume of letters sent through it. On the other hand, with the intention of fully privatizing its ownership and removing it from the state.

Key Figures

about NIS 694 million

the deficit in the Company's working capital as of December 31, 2021

about 13,000 square meters of built-up area

the built-up area leased by the Postal Company in phase A for the establishment of an online trade center in the Postal Campus in 2016

about 31,000 square meters of built-up area

the built-up area that the Company leased in phase B for an operational space and the headquarters offices in the Postal Campus in 2017

about a year and a half

the delay in entering the Postal Campus since the initially planned date, March 2021 instead of July 2019

about NIS 90 million

the cost of the adjustment works to the Postal Campus property, done in phase B through three separate engagements without a tender

about 100% budget overrun

in the property adjustments budget in phase B: from about NIS 45 million in planning to about NIS 90 million in practice

about NIS 19 million

the annual rent of the Postal Campus in its entirety from 2021

154 out of 335

of the Company's real estate assets are not properly registered in the land registry in the Company's name

Audit Actions

From August 2022 to March 2023, the State Comptroller's Office examined the establishment of the Postal Campus, especially phase B of the project. The audit was mainly carried out at the Postal Company, the Government Companies Authority, and the Postal Administration at the Ministry of Communications (the follow-up audit).

Furthermore, the State Comptroller's annual report 68A published in 2017 (the previous audit) dealt with property management at the Postal Company. In the follow-up audit, the State Comptroller's Office checked the deficiencies rectifications and the implementation of the recommendations made therein.

Key Findings

Meeting Deadlines for Completion of Phase B of the Project – the Transfer of the Headquarters to Modi'in – the completion of phase B of the project, including the completion of the relocation of the headquarters offices, has been postponed from the planned date in the second quarter of 2019 to the first quarter of 2021 – a delay of about a year and a half. This considerable delay resulted, among other things, from the changes in the Company's decisions during the execution of the project, including the decision to establish galleries for the offices, which delayed the receipt of the occupancy permit and other approvals.

Budget Overrun to Carry Out Adjustment Work for the Leased Property – the first contract for phase B of the project was NIS 45 million to adjust the property to the Company's needs. Still, in practice, the Company spent about NIS 90 million. The property adaptations to the Company's needs included, among other things, the construction of offices and public areas, the expansion of a cash Security center, and the construction of a bridge between the buildings.

Utilization of the Headquarters Office Space in the Postal Campus – it was found that in the Postal Campus, many areas are not being used, including areas intended to be used as the Postal Bank's call center, a dining room, a gym, and a dental clinic, and this, also as a result of the efficiency plans which led to a decrease in the number of employees as well as a consequence of the transfer of many employees to work from home. According to the lease signed by the Company, the campus areas subletting is available. As of the audit end date – March 2023, the Company has not started carrying out staff work to promote the possibility of subletting unused areas in the Company's structure. Compared to the many empty spaces in the headquarters offices area, it was raised that there is overcrowding in the operational areas – the overcrowding in the sorting complexes forces the Postal Company to try and utilize every potential space, which causes it to store mail pallets, carts, and equipment also in the transit corridors on the north side of the campus which significantly block the escape routes from the sorting areas in case of emergency or fire.

Examining the Economic Viability of the Alternatives for Carrying Out Phase B of the Project – the decision to carry out phase B of the project, relocating the headquarters units to the Postal Campus in Modi'in, was based on an economic examination (calculation) conducted at the Postal Company to choose one of the alternatives: (a) Continuation of the current activity – leasing or possession in existing buildings; (b) The leasing alternative – the sale of the existing properties and the leasing of the area in Modi'in; (c) The alternative of the partial purchase: the sale of the existing properties, the purchase of 50% of the space in Modi'in and the leasing of 50% of it. The audit raised that in the economic calculation conducted by the Company, following which the lease alternative was selected and approved by the board of directors, substantial economic data were not considered that could have reversed its conclusions and favored the partial purchase alternative since they improve the calculation of the current value of the partial purchase alternative by about NIS 21.1 million. Among other things, the data that were not included in the calculation include an actual increase in the value of real estate assets over time (NIS 12.2 million); A lower probability of moving from the property in the partial purchase alternative versus full leasing (NIS 6.1 million); And the high likelihood, given the Company's financial situation, that no tax will be paid for appreciation in the partial purchase alternative (NIS 2.8 million). However, it should be noted that the rent paid by the Postal Company for the operating areas and office space is slightly lower than the average for similar properties examined in the Postal Campus area.

The Decision-Making Process in the Postal Company Board of Directors and Management on the Establishment of the Postal Campus and the Supervision and Control of the Implementation of Phase B of the Project

- It was found that the Company's management did not examine other alternatives for purchasing or leasing elsewhere. Therefore, the board of directors did not discuss or instruct them to find them.

- It was raised that the board of directors at that time did not supervise significant issues of the execution of the project – budget, the meeting of goals, and examining alternatives, and that the Company's management did not regularly present it with reports on the management of construction works, meeting deadlines and other parameters involved in completing the project and relocating the headquarters offices.

- To supervise and control phase B of the project, the Company appointed on December 24, 2017, a supreme steering committee that was assigned the following tasks: (a) Approval of the project's general work plan; (b) Monitoring the project's progress; (c) Making decisions on material issues; (d) Budgetary monitoring. It was found that the steering committee convened only six times between January 2018 – July 2019. After this date, there is no documentation of the steering committee convening, even though the project was completed about a year and a half later, in March 2021. Upon completion of the project, the supreme steering committee stopped meeting, which contradicted the definition of its role and responsibilities in the letter of appointment, indicating that the Company did not implement a required management and supervision process at the company's senior level.

Contracting Through an Exemption from Tender for the Property Lease as Part of Phase B of the Project – the Company has determined that the engagement can be made as a follow-up engagement to the contract from March 10, 2016, for the lease of the space of the online trade center (the first engagement) at a cost of about NIS 5.2 million annually, and this without conducting a public tender under Regulation 3(4) of the Mandatory Tender Regulations which requires, as an essential condition, that the contract be on the same terms or more favorable terms compared to the first engagement. It was found that the additional contract at the cost of about NIS 12.4 million annually, which was signed for phase B, is not under conditions identical to those of the first engagement (apart from rent per square meter for part of the area which is an operational area) or under more favorable conditions than those of the first engagement. It is very doubtful whether the Company met the requirements of Regulation 3(4) to receive an exemption from a tender.

Contracting Through an Exemption from a Tender for Adjustment Works in the Leased Property as Part of Phase B of the Project – it was raised that the three engagements between the Postal Company and Company A for the adjustments in the leased property in phase B of the project, for over than three years and substantial sums of about NIS 90 million – constituting an 800% increase compared to the first engagement (in which sums of NIS 10 million were included to make adjustments to the leased property), were carried out without a tender and using an exemption that allows engagements without a tender according to the Mandatory Tenders Regulations when this too was only for some of the engagements (about NIS 45 million out of about NIS 90 million). Therefore, the three engagements for adjusting the leased building for the Company's use, at about NIS 90 million, were carried out without a tender and without meeting the conditions of Regulation 3(4) for granting an exemption from a tender. This is also inconsistent with the principle of public tender preference anchored in the Mandatory Tenders Regulations.

Completion of the Relocation of the Headquarters Units and Operational Units to the Postal Campus – it was found that six headquarters units, for which the Company bears an annual property tax of about NIS 725,000, have not yet been relocated to the Postal Campus as planned, and contrary to the reason for the establishment of said campus. It was also raised that one of the units is located a short distance from the Postal Campus, and rent and property taxes are paid at about a quarter of a million NIS annually.

The Number of Government-Supplied Vehicles – it was found that concurrently with the Company's activity being transferred to the Postal Campus, the number of employees entitled to receive a government-supplied vehicle instead of reimbursement for car expenses increased. In 2017−2021, there was a 60% increase in the number of government-supplied vehicles (from 279 vehicles to 447) to the various Company employees, alongside a 210% increase in the costs of owning these vehicles (from about NIS 5 million to about NIS 16 million). This is inconsistent with the decrease in the scope of activity and the overall workforce in the Company. It was not found that the company prepared financial estimates for the increase in the Company's expenses following the expected increase in the number of government-supplied vehicles due to the transfer of many employees to work in the Postal campus. Additionally, the Company did not perform any work to compare travel costs before and after the relocation to the Postal Campus.

The Absence of an External Supervisor for the Establishment of the Headquarters Offices and the Resulting Financial Costs – it was found that the assignment of project management for the establishment of the headquarters offices and its supervision to the Company's construction department, which lacks the experience and skill necessary for the scope of the project, and not to an external manager-supervisor who specializes in such work, as is customary, adversely affected the project management and supervision. The late detection of the construction delay and the lack of controls on the full execution of the bill of quantities and the proper management of the work log indicates a deficiency in the Company's monitoring of the progress of the works and its control over the expenses involved in the project. A discrepancy arose between the amount the Company committed to regarding the payment in phase B of the project for the performance of adjustment works in the leased property, at about NIS 55 million, and the actual expenditure. It was agreed between Company A, which leases the property, and the Postal Company that the Postal Company would pay an additional NIS 33 million (an addition of about 60% to the sums committed in the agreements signed up to that time).

The Asset Management Computerized System – the previous audit found that the "real estate module" in the SAP system – used by the Company's Assets Department – is cumbersome, does not allow for quick and easy retrieval of structured reports and of essential data required for the day-to-day work, and the generating of the necessary information requires in many cases the export of data to "Excel" software to process it. It was also found that there is no congruency between the data of the Logistics Department and the data of the Finance Department. **The follow-up audit raised that**

these deficiencies, were rectified to a small extent. The system allows issuing an orderly cash flow report for each asset but not issuing a yield report. In addition, the computerized system has not been improved as required, and the Assets Department employees still have difficulty using it to manage the real estate assets properly. It was further found that the system does not have a connection to a GIS, even though it may contribute to optimal management of the property and to receive information about its geographical environment, and it does not enable management of the whole issue of the accessibility of the properties according to law.

Utilization of Empty Spaces Owned by the Postal Company that Were Previously Used by the Company and Were Vacated – the previous audit found that the property, spanning an area of 650 square meters on 7 Rogozin St. in Ashdod, mainly was empty for about nine years and did not generate income. The estimated rent for this property is about NIS 500,000 a year, while the Postal Company bears the property tax costs of about NIS 186,000 a year. At the same time, the Company leased another property in Ashdod City spanning an area of 276 square meters, which serves as a replacement for the property on Rogozin Street and for which the Company bears rent of about NIS 154,000 a year and property tax costs. **The follow-up audit raised that the deficiency had not been rectified.** During the follow-up audit, a similar deficiency occurred regarding the Oasis branch on Jabotinsky Street in Ramat Gan, which used to be an essential branch spanning an area of 244.5 square meters. The branch was closed in May 2022, and it had not been leased out as of the audit end date. The estimated rent that the Company could receive for renting this property was about NIS 410,000 per year, at least, while today, the Company bears high property tax costs at about NIS 105,000 per year.

The Operational Need for the Establishment of the Postal Campus – in the former sorting house in Tel Aviv, there were substantial deficiencies and delays in handling online trade items, and the building was not flat enough as required. Establishing the online trade center was necessary and improved the Company's handling of these items.

The Registration of the Company's Assets in the Land Registry – the previous audit found that registering the Company's real estate assets was completed for only 7.5% of the assets. The follow-up audit raised that there has been a considerable improvement in this matter, and as of June 2022, the registration of 54% of the properties has been completed.

Key Recommendations

- It is recommended that the Postal Company consider the relocation of all the units above to the Postal Campus as initially planned. This will contribute to the reduction of the costs borne by the Company for the areas and offices where those units are currently located and will contribute to the realization of the vision of consolidating all the required functions in one place and creating synergy between them, a vision which was the basis of the establishment of the Postal Campus.

- It is recommended that the Company strengthen its controls on material economic calculations and that additional assumptions be presented in these calculations to increase the scope of the examination and its justification. The Company's board of directors must continuously monitor the implementation of the Company's policies, plans, and budgets, and it is recommended to exercise greater involvement in the implementation of strategic projects and monitor actions that have an impact on the Company's financial situation over time.

- It is recommended that the Postal Company implement its plan to substantially reduce the areas in the headquarters offices and promote the intake of additional units or subletting. This will contribute to the optimal utilization of the areas, savings, and finding further sources to help the Company contend with its current financial difficulties.

- Given the enormous volume of properties whose registration has not yet been fully regulated, it is recommended that, in addition to the improvement trend it has presented, the Company increases its efforts to regulate, in cooperation with the Israel Land Authority and the Land Registry, the registration of all its properties as required. This is also due to the Company's planned privatization procedure.

- The Company should prioritize, to the extent possible, the execution of contracts through a public tender under the Mandatory Tenders Law and Regulation 1b of the Mandatory Tenders Regulations, even when there is an option to use an exemption from a tender. If the Company is considering an exemption according to a specific regulation, it must verify its compliance with the conditions of the regulation. It is further recommended that the Postal Company learn lessons from the engagements to execute adjustment works in the leased property and incorporate the conclusions into future activity.

- In establishing significant and substantial real estate projects, the Company is recommended to appoint a professional supervisor with the necessary experience and qualifications, specializing in projects of this type.

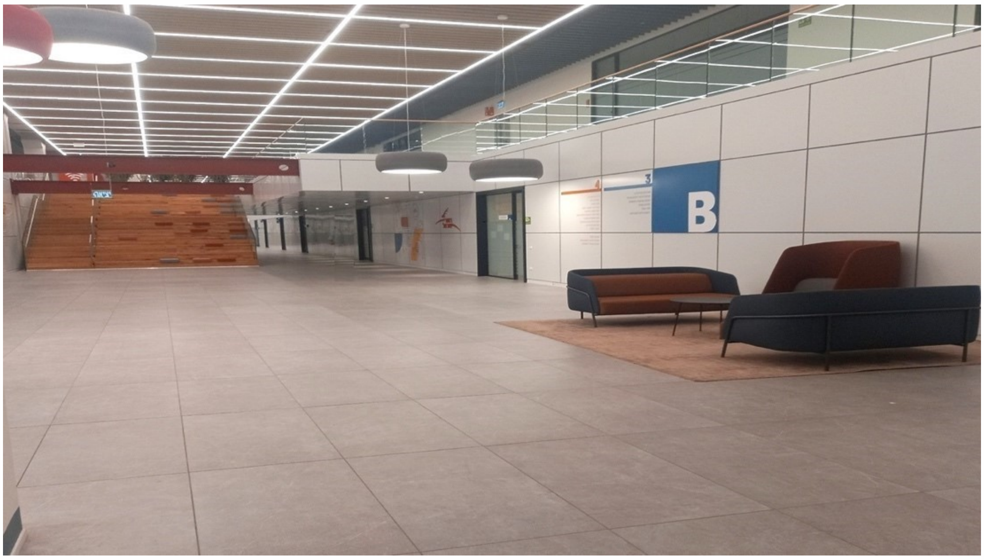
The Postal Campus Structure

Source: a presentation to the Company board of directors - "Postal Complex Israel October 2017".

* Phase B of the project (the headquarters offices and the operational area) dominates the two eastern buildings (right), and Phase A of the project (the online trade center) includes the ground floor area that is common to all four buildings[1].

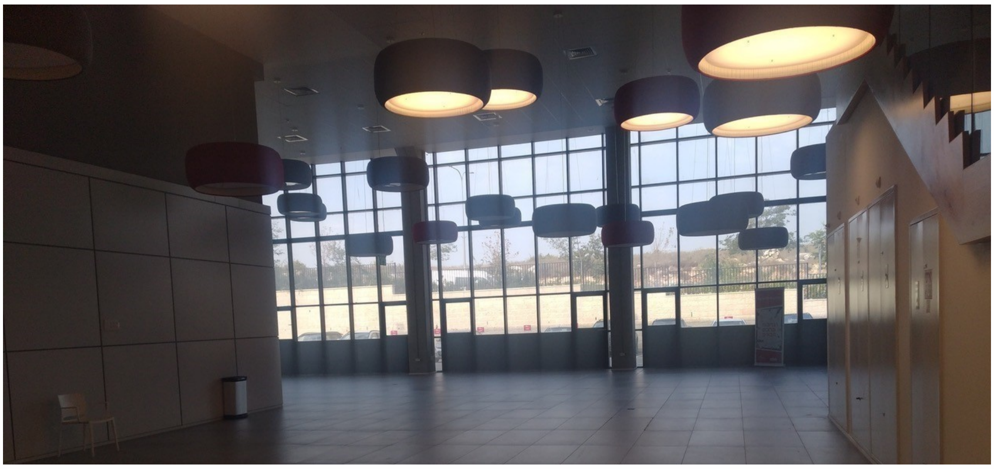
1 Furthermore, according to the lease agreement, the Postal Company was granted the exclusive right to use the lower area of the outer yard, where the loading and unloading of postal items on the trucks is carried out.

Part of the Office Space of the Headquarters Established as Part of Phase B of the Project



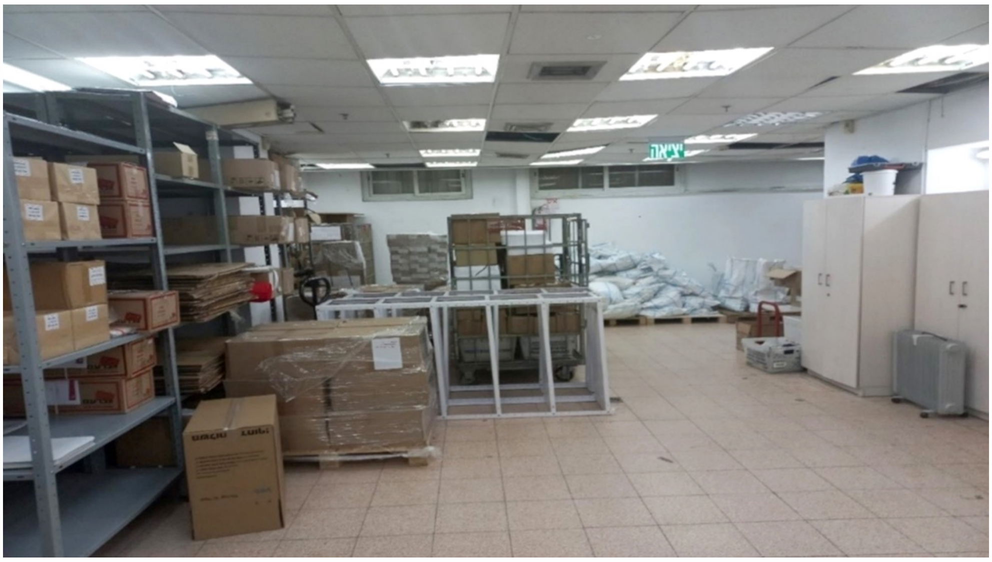
Taken by the audit team in March 2023.

A Compound Intended as a Dining Room that Remains Empty and Unused



Taken by the audit team in November 2022.

Operational Area that is not in the Postal Campus – the Philatelic Service in Bat Yam



Taken by the audit team in December 2022.

Summary

In 2016 – 2017, the Postal Company established the online trade center in Modi'in. The establishment of the online trade center helped the Company meet the ever-increasing volumes of international postal item traffic, which is the main activity of the Israel Postal Company today and its main growth engine. Later, the Company established its headquarters and the Postal Bank offices in the same complex, becoming the Postal Campus. The audit raised significant deficiencies in the planning and management of the project. The project did not have a dedicated budget, and adjustments and improvements were made to the leased property worth tens of millions of NIS without receiving the required approvals from the Company's board of directors and without a tender for their execution, as required by law. Furthermore, the audit raised that the Company's level of supervision and control over the planning and management of the project was low and poor when it chose to manage such a substantial project that goes beyond the scope of its current activities independently and without having complete supervision and control mechanisms.

It was further found that there was a delay in the completion of the project, that after the completion of the project, there is seasonal overcrowding on the operating and sorting floor in the Postal Campus, and that there are operational "bottlenecks," in contrast to the presence of large unused areas on the floors used by the headquarters offices. Moreover, the relocation of units that were supposed to move to the Postal Campus in Modi'in and thus contribute to significant financial savings for the Company has yet to come to fruition. The Company has taken on a heavy financial burden manifested in a high initial investment and an unnecessarily spacious construction that will burden the Company's budget for many years and has the potential to contribute to its financial difficulties.

The Company should rectify the deficiencies concerning the real estate assets in its possession, some of which were already raised in the previous audit, and, among other things, complete the legal registration process. By improving assets management, a material infrastructure should be created for the Postal Company's financial stability and growth, including as part of a future privatization process.

The Postal Company's reply in June 1, 2023 (the Company's reply) stated that "the Company accepts the recommendations of the draft audit report and believes it contains quite a few insights and lessons learned from the implementation of such a complex project of establishing the Postal Campus after about 20 years in which the management of the Postal Authority and the Israel Postal Company examined the matter".

The Rectification Extent of the Key Deficiencies Noted in the Previous Report

The Audit Chapter	The Audited Body	The Deficiency Noted in the Previous Audit	The Rectification Extent of Key Deficiencies Noted in the Follow-up Audit			
			Not Rectified	Slightly Rectified	Significantly Rectified	Fully Rectified
Registration of real estate rights	The Israel Postal Company	The previous audit found that most of the Postal Company's assets are not fully registered.				
Procedure for inspection and supervision of real estate maintenance	The Israel Postal Company	The previous audit found that the Company does not have an inspection procedure and that the Company's real estate committee does not receive reports on this topic.				

The Audit Chapter	The Audited Body	The Deficiency Noted in the Previous Audit	The Rectification Extent of Key Deficiencies Noted in the Follow-up Audit			
			Not Rectified	Slightly Rectified	Significantly Rectified	Fully Rectified
Ashdod City branch and the evacuation of Rogozin Branch	The Israel Postal Company	The previous audit found that the property, spanning an area of 650 square meters on 7 Rogozin Street in Ashdod, has been mostly empty for about nine years and did not generate income. The Postal Company bears the property tax costs. At the same time, the Company leased another property in Ashdod City spanning an area of 276 square meters, which serves as a replacement for the property on Rogozin Street and for which the Company bears rent and property taxes.				

The Audit Chapter	The Audited Body	The Deficiency Noted in the Previous Audit	The Rectification Extent of Key Deficiencies Noted in the Follow-up Audit			
			Not Rectified	Slightly Rectified	Significantly Rectified	Fully Rectified
The Migdal David property	The Israel Postal Company	The previous audit found that the Company pays rent higher than the market price, contrary to the agreement that the rent will be at an amount determined by the Government Appraiser – an amount significantly lower than the amount paid.				
Leasing buildings without a building permit	The Israel Postal Company	The previous audit found that the Company does not have a binding procedure according to which it must ensure that the properties it leases have a building permit and meet its conditions.				

The Audit Chapter	**The Audited Body**	**The Deficiency Noted in the Previous Audit**	**The Rectification Extent of Key Deficiencies Noted in the Follow-up Audit**			
			Not Rectified	**Slightly Rectified**	**Significantly Rectified**	**Fully Rectified**
Adjusting the computerized system for asset management	The Israel Postal Company	The previous audit found that the "real estate module" in the SAP system – used by the Company's property department – is cumbersome, does not allow for quick and easy retrieval of structured reports and essential data required for daily work, and to generate the necessary information. Most often information is transmitted to the "Excel" to process them. Moreover there is no match between the data of the Logistics Department and the data of the Finance Department.				