Report of the State Comptroller of Israel | May 2025

Ministry of Finance

The Financial Statements of the State of Israel as of December 31, 2023 – Government Capital Funds

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Background

Under section 12 of the State Comptroller's Law, 1958 [Consolidated Version], every year – at a time determined by the Comptroller, but no later than six months after the end of the State's fiscal year – the Minister of Finance shall submit to the State Comptroller "a comprehensive account of the State's revenues and expenses in the same year". The section further stipulates that at a date set by the Comptroller, but no later than nine months after the end of the State's fiscal year, the Minister of Finance will submit to the State Comptroller the "balance sheet of the State's rights and liabilities as of the end of the fiscal year". The State's consolidated financial statements for December 31, 2023, were submitted to the State Comptroller and published on June 30, 2024.

2023 ended with a net accounting deficit of approximately NIS 132 billion. Compared to 2022, this represented an increase of approximately NIS 203 billion (from a net accounting surplus of about NIS 71 billion to a net accounting deficit of approximately NIS 132 billion). This net accounting deficit in 2023 was driven by a rise in state expenditures relative to 2022, particularly a NIS 24.9 billion increase in war-related spending in the last quarter of 2023, coupled with a decline in state revenues following a sharp rise in 2022.

The impacts of the war were primarily reflected in a decrease in the employment rate, reduced private spending, and a substantial rise in public spending, especially defense expenditures. Despite a continued decrease in inflation to the target range, the fiscal front experienced a budget deficit exceeding planned levels. The significant increase in financing needs consequently led to a notable rise in debt issuance in the last quarter of 2023, resulting in a debt-to-GDP ratio of 61.9% in 2023, up from 60.5% in 2022, despite expectations of a continuing downward trend. Amid growing uncertainty, credit rating agencies responded to geopolitical developments and shifts in Israel's macroeconomic and fiscal indicators by downgrading the credit rating and adjusting the rating outlook.

The "Iron Swords" war has significantly adversely affected Israel's macroeconomic indicators. The continuation of the conflict beyond the preparation date of the financial statements and the completion of the audit is expected to result in further deterioration of these indicators, necessitating the implementation of a responsible fiscal policy led by the Ministry of Finance.

Government capital funds are utilized to manage unique governmental activity while establishing an accounting and budgetary distinction between the funds' activities and the government's regular operations. The legitimacy and status of government capital funds may arise through statutory means (statutory capital funds) or by government resolution or administrative initiative (initiative capital funds). Some of these funds are budgetary (budgetary capital funds), while others are extra-budgetary (extra-budgetary capital funds). Key capital funds include the Compensation Fund (Property Tax Fund), the Fund for Israeli Citizens (Wealth Fund), the State Guarantee Fund, the Cleanliness Fund, the IDF Camp Relocation Fund, the Metro Fund, and the Internal Government Insurance Fund.

Capital funds are established to fulfill various objectives, such as safeguarding against financial losses that may occur due to unforeseen events, bridging financial gaps between revenue and expenditure timelines in large annual and systemic projects, consolidating financial resources to achieve specific goals, and managing funds for future generations.

Key Figures

NIS 77.1 billion

The 2023 budget deficit amid the Iron Swords war

Approximately 79%

Percentage of entities that submitted on time audited financial statements for the end of 2023

4 government ministry entities

Did not submit audited financial statements to the Accountant General on the required date in each of the years 2019–2023

NIS 8 billion

The financial scope of 38 deposits managed by the Accountant General that are classified for accounting purposes as liabilities, although some of them may be capital funds that should be presented as part of capital

Approximately 187%

The rate of increase in the number of reported extra-budgetary capital funds in the years 2011–2024 (from 8 funds to 23)

25%

The percentage of reported extra-budgetary capital funds for which no documents confirming their establishment were found in the Accountant General Division (4 funds out of 16)

Approximately 63%

Rate of extra-budgetary capital funds and third-party deposits[1] for which the interest rate for depositing their funds with the Accountant General has not been determined (32 funds out of 51)

NIS 4.76 billion

Total funds withdrawn from the compensation fund in 2023 (first three months of the war)

NIS 2.26 billion

Total budgetary funds withdrawn from the Cleanliness Fund in the years 2015–2021 and converted into "authorization to commit"

1 Which are managed together in deposits deposited in the Accountant General's account.

Audit Actions

Between June and October 2024, the Office of the State Comptroller conducted an examination of various aspects pertaining to the management of government capital funds. This examination took place within the Accountant General's Division of the Ministry of Finance (Accountant General's Division) and the Budget Division of the Ministry of Finance (Budget Division). Additional examinations were undertaken at "Inbal Insurance Company Ltd." (Inbal Company).

Key Findings

Analysis of Trends Emerging from Financial Statements as of December 31, 2023

- In 2023, a net accounting deficit of approximately NIS 132 billion was recorded. In comparison to 2022, the net accounting deficit increased by approximately NIS 203 billion, transitioning from a net accounting surplus of approximately NIS 71 billion to a net accounting deficit of approximately NIS 132 billion. The net accounting deficit in 2023 was influenced by a rise in state expenditures relative to 2022, particularly an increase of approximately NIS 24.9 billion in net war expenditures[2], coupled with a decline in state revenues following a marked increase in state revenues in 2022. Total state assets reported in the financial statements increased in 2023 compared to the previous year, amounting to approximately NIS 2,049 billion, while state liabilities escalated to approximately NIS 3,347 billion. Consequently, net state liabilities reached approximately NIS 1,298 billion in 2023.

- The implications of the war were primarily manifested in a reduced employment rate, diminished private expenditure, and a substantial rise in public expenditure, particularly in defense spending. In monetary terms, inflation persisted within the target range; However, a greater-than-anticipated budget deficit was recorded on the fiscal front. Given the significant escalation in financing requirements, the volume of debt issuance increased markedly during the last quarter of 2023. Debt issuance occurred in both the domestic tradable market and global markets, amounting to NIS 160 billion, of which approximately NIS 81 billion was raised since the onset of the war. In this context, the debt-to-GDP ratio increased to 61.9% in 2023 compared to 60.5% in 2022, contrasting with prior expectations of a continued downward trend. Credit rating agencies responded

2 Net war expenditure (according to the deficit calculation) is war expenses minus payments from the compensation fund.

to geopolitical developments and alterations in the macroeconomic and fiscal indicators of the State of Israel by downgrading the credit rating and adjusting the rating outlook negatively.

- State revenues in 2023 decreased by NIS 42 billion in comparison to 2022, from NIS 695 billion to NIS 653 billion, reflecting a decrease of approximately 6%. This decline in revenues was primarily attributable to a 4% reduction in revenues from taxes and fees, driven by a decrease in real estate taxes and value-added tax (VAT), indicative of a downturn in real estate market activity and a contraction in private consumption, particularly in light of the Iron Swords War. Additionally, revenues from barter transactions in 2023 experienced a decline of approximately 15%, primarily due to the non-reflection of receipts from land sales within the "Income from barter transactions" category, unlike in previous years.

- State expenditures in 2023 totaled approximately NIS 785 billion, in contrast to approximately NIS 625 billion in 2022, signifying an increase of approximately 26%. The total war-related expenses incurred in 2023 were estimated at approximately NIS 29.6 billion, alongside additional liabilities amounting to approximately NIS 2.5 billion. War expenses were classified into security expenses, totaling approximately NIS 18.2 billion, and civilian expenses, amounting to approximately NIS 11.3 billion. The principal contributor to the variance relative to 2022 was an increase of approximately 61% in expenses for transfers and support, which arose, inter alia, from modifications in the actuarial liability balance of the National Insurance Funds and compensation payments for reservists related to the war.

Submission of Audited Financial Statements of State Entities Prior to the Publication date of the State's Consolidated Statements – The state's financial statements for the year 2023 encompassed financial data from 214 entities. An unqualified opinion was issued for the financial statements of 131 entities (61%). Nonetheless, at the time of preparation of the state's financial statements, 46 entities (21%) had not submitted their audited financial statements. Moreover, a review indicated that a majority (66%) of the entities included in the state's financial statements from 2019 to 2023 had submitted a minimum of four audited statements over the last five years preceding the publication of the state's financial statements. However, 23% of the entities had provided audited statements in only two of the last five years at the time of publication. The failure to submit this information in a timely manner hinders the capacity to assess the financial status of these entities, the degree of compliance of their reporting with generally accepted accounting principles, and the completeness of the state’s financial statements. This is concerning as the audited information published subsequently may differ materially from the data utilized in preparing the consolidated financial statements of the State of Israel.

- **Management of Government Capital Funds in the State's Financial Statements –** Budgetary capital funds are incorporated in the state budget, under the purview of the Budget Division, whereas extra-budgetary capital funds are excluded from the budget and are managed by the Accountant General Division. The audit revealed that the Budget Division does not maintain a comprehensive list detailing the number and scope of budgetary funds, notwithstanding that some of these funds are statutory. The Accountant General Division, on the other hand, maintains a registry of 54 extra-budgetary capital funds and third-party deposits, which collectively account for approximately NIS 44.4 billion, but only 16 capital funds totaling roughly NIS 36 billion are reported in its financial statements. This discrepancy suggests that the Ministry of Finance lacks precise information concerning both budgetary and extra-budgetary funds. Additionally, the Accountant General Division does not possess a list of all budgetary capital funds, even though the necessity for a complete catalog was identified in 2007 to ensure accurate reflection in financial statements. With the exception of the Cleanliness Fund, other budgetary capital funds material from both quantitative and qualitative perspectives were omitted in the relevant note to the financial statements, thus impairing the completeness of information available to users regarding the number and financial scope of capital funds.

- **Definitions for Capital Funds –** The Accountant General Division defined the terms "fund", "budgetary fund", and "extra-budgetary fund" as outlined in TAKAM (Financial and Economic Regulations) Directive No. 2.2.9 of October 2011. However, significant discrepancies were found in the definitions of these terms between the Accountant General Division and the Budget Division. Furthermore, notable differences exist between the definitions articulated in TAKAM Directive No. 2.2.9 and the actual accounting definitions utilized by the Accountant General Division. Such inconsistencies foster a lack of uniformity in the classification of capital funds between the divisions, which is reflected in their reporting practices. Examples of these capital funds include the Vehicle Fund, the IDF Camp Relocation Fund, and the Metro Fund.

- **Reporting of Capital Funds in Financial Statements –** The audit uncovered inconsistencies in the reporting of capital funds across various financial statements from different years. These inconsistencies contribute to disorder in reporting practices and undermine the transparency of data presentation related to capital funds for users of the financial statements. In the absence of a cohesive accounting standard or procedures for the presentation of capital funds within the Accountant General Division, presentation format may vary across financial statements, resulting in a lack of uniformity concerning the number of funds and their scope over time, which undermines the intended purpose of public information dissemination.

- **Agreed Framework for Capital funds –** The audit highlighted the absence of a mutually agreed framework between the Budget Division and the Accountant General Division, leading to a lack of essential information required to map all capital funds, both budgetary and extra-budgetary. Consequently, the Accountant General Division does not possess comprehensive information about all budgetary funds, although it reflects their share in the relevant note within the financial statements, while the Budget Division lacks information regarding all extra-budgetary funds, potentially misallocating those resources.

Establishment of Extra-budgetary Capital Funds – From the date of publication of the TAKAM directive in 2011 until the audit end date in October 2024, 43 deposits (extra-budgetary capital funds and third-party deposits) recognized by the Accountant General Division were established, constituting an approximate 80% increase in their quantity. The Accountant General Division did not identify supporting documentation for the establishment of the majority (52%) of these deposits, despite approximately 82% (23 out of 28) being created after the issuance of TAKAM Directive 2.2.9, which mandates approval for the establishment of extra-budgetary capital funds. Given the lack of a clear differentiation within the Accountant General Division between extra-budgetary capital funds and third-party deposits, there are concerns regarding the establishment of capital funds without requisite approvals.

Regulation of Characteristics of Capital Funds – The audit indicates a deficiency in the uniform regulation of capital fund characteristics concerning the safeguarding of fund designations, the procedures for transferring surpluses or reserves across fiscal years, and the methods of accumulating interest or investing reserves in capital funds, even for funds aiming to achieve similar objectives. Furthermore, basic documentation to regulate the designation and status of several capital funds was not located. Consequently, the capacity of capital funds to fulfill their objectives over time may be compromised.

- **Transfer of Capital Fund Surpluses –** The process for transferring surpluses accrued in budgetary capital funds occurs under the umbrella of state budget surpluses. The completion of requirements for transferring these budget surpluses may take several months, potentially compromising timely expenditure realization. Additionally, the execution rates reflected in state budget items encompassing budgetary funds are notably low and skewed, even though there is no intention to conduct all budget year expenditures, rather aiming to reserve unutilized funds in the capital fund for designated future uses.

- **Ensuring the Designation of Capital Funds –** The audit revealed the importance of ensuring that capital fund resources be utilized solely for the purposes for which they were established; However, the incorporation documents of certain funds do not stipulate such assurance. Notable examples of funds lacking assurance clauses include the Internal Fund, the State Guarantee Fund, the IDF Camp Relocation Fund, and the Metro Fund.

    - **Budgetary Level –** The Budget Division has previously redirected unutilized funds from budgetary capital funds to address fiscal challenges by reallocating their budget sources for alternative uses, subsequently authorizing commitments of equal amounts in favor of those funds. This practice, as evidenced by the diversion of funds from the Cleanliness Fund during the years 2016–2023, totaling NIS 2.26 billion approved from 2016 to 2021, serves merely as a one-off fix without addressing underlying fiscal issues, deferring these challenges until the fiscal year when the authorization to commit will be executed. Furthermore, the reallocation of funds for alternative purposes, as demonstrated with the Cleanliness Fund, was executed without a coherent mechanism, contravening the intended goals for which the capital funds were established.

  - **Financial Level –** The Accountant General Division’s current practice lacks a mandate for safeguarding the funds of capital funds, as they are utilized by recording liabilities in their favor, despite potential economic justification for such an approach.

- **Capital Fund Deposits –** The audit revealed that the provision outlined in TAKAM Directive 2.2.9 concerning the preparation of a deposit agreement for the deposit of extra-budgetary capital fund resources and third-party deposits within the Accountant General Division’s deposit account is not being duly implemented. Among the 51 deposits reported by the Accountant General Division, deposit documentation is absent for 7 deposits (14% of the total), and there is no specification of interest rates for 17 deposits (33% of the total). Moreover, the interest rates applied by the Accountant General Division, as dictated by its policy, lack uniformity. Certain deposits do not accrue any interest, while others receive interest at varying rates, which may correspond to the Accountant General Division’s rate, a fraction of it, a fixed interest rate, or a rate determined by the interest of the Bank of Israel or government bond rates. The inadequate return on the deposits of extra-budgetary capital funds in the general account has the potential to subject their remaining value to real depreciation, particularly in an inflationary environment.

- **Compensation Fund Balances –** The Compensation Fund balances at the onset of the Iron Swords War were anticipated to be adequate for financing compensation payments, as delineated in the red track of the Compensation Fund Regulations of 1973. It was determined that as the war progressed and the regulations underwent expansion, including the introduction of additional criteria, concerns arose regarding the fund's capacity to fulfill the obligations incurred as a result, within the existing accrual framework, without an increase in funding. The State Comptroller’s report from 2012, which addressed the damages resulting from the Second Lebanon War, indicated: "It is uncertain whether the fund balance, which in August 2011 reached approximately NIS 3.4 billion, will suffice to compensate for damages attributable to the onset of a comprehensive war, the magnitude of which is anticipated to significantly exceed the damages incurred on the home front in previous conflicts".

Unqualified Opinion on the Financial Statements – The state's financial statements for the year 2023 encompassed financial data from 214 entities. An unqualified opinion on the financial statements was issued for 131 entities, representing 61%. Since 2021, there has been an upward trend in the proportion of audited statements within the state's financial statements, with approximately 79% of the financial statements audited in 2023, in contrast to 66% in 2020.

Key Recommendations

- The Iron Sword War exerts a substantial negative influence on the macroeconomic indicators of the State of Israel. The persistence of the conflict beyond the date of preparation of the financial statements and the audit end date will likely result in further deterioration of these indicators and necessitates the implementation of a prudent fiscal policy overseen by the Ministry of Finance.

- The heads of the relevant entities – namely, the Ministry of Defense, the Ministry of Public Security, the Ministry of Education, and the Israel Land Authority – are obliged to submit the audited reports of their respective entities to the Accountant General in a timely manner, while also maintaining continuous communication with the Accountant General's Division to facilitate this process.

- It is advisable for the Accountant General's Division and the Budget Division to collaboratively explore the potential for standardizing the definitions of fundamental terms to enhance transparency and consistency in reports concerning capital funds within financial statements and ministry budget systems. Furthermore, it is pertinent for the Accountant General's Division and the Budget Division to devise a unified framework for the establishment of capital funds and the coordination of information pertaining to their scope, ensuring systematic monitoring, including the documentation of their income and expenses. Such a framework would promote clarity, certainty, and reliability in the budgeting processes of capital funds and their representation in financial statements. Should the Accountant General's Division and the Budget Division fail to achieve a consensus, it is recommended that the management of the Ministry of Finance render a decision on this matter.

- It is recommended that the Accountant General's Division establish procedures dictating the presentation of capital funds within financial statements, thereby anchoring their presentation in a standardized manner and enhancing the clarity of the information conveyed to the public, as well as the reliability of the data included in the financial statements.

- The Accountant General's Division should address the prevailing practice whereby capital fund resources are utilized for purposes not specified in their incorporation documents while simultaneously recording liabilities in their favor, even in instances where there appears to be an economic benefit. Moreover, it is recommended that the Debt Unit within the Accountant General's Division conduct a thorough examination of the advantages of utilizing capital fund resources to finance existing government liabilities based on historical data, ensuring that there is an economic rationale for such practices. This examination must consider, among other factors, the costs associated with raising debt when the necessity arises to liquidate capital funds, market conditions at those times, and the feasibility of liquidating multiple funds concurrently.

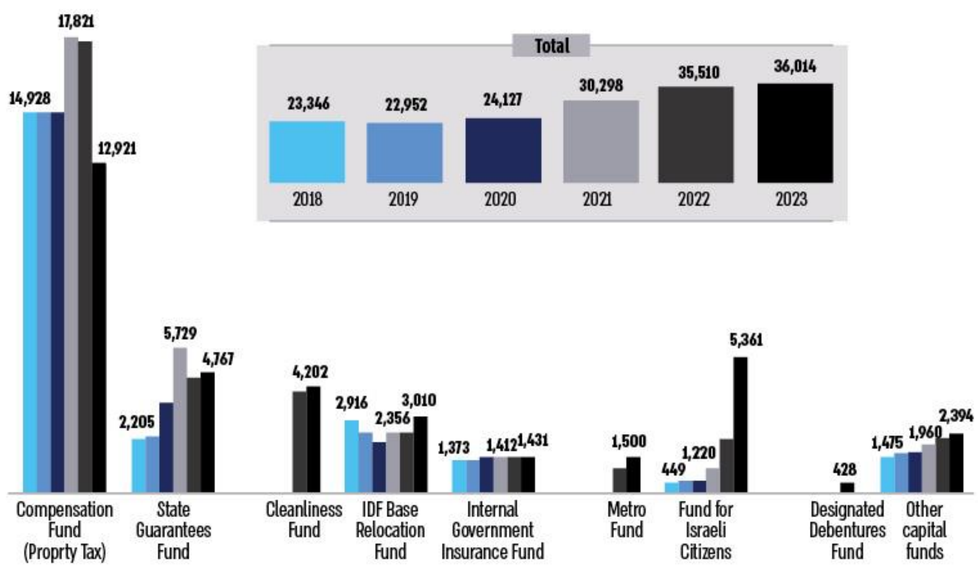
- The characteristics of the Iron Sword War suggest a significant extent of damage resulting, among other factors, from its extended duration. It is conceivable that the expansion of regulations for disbursement from the Compensation Fund may coincide with a reduction in state revenues and increased demands for budgetary expansion. Consequently, it is recommended that the Ministry of Finance derive lessons from the extent of compensation provided and adjust the fund's reserves accordingly.

- It is advised that the Ministry of Finance ensure that all capital funds possess incorporation documents and establish a standardized mechanism for determining their characteristics in accordance with these documents, particularly when the objectives of these funds are similar. Such a mechanism will serve to safeguard their status and ensure the realization of their intended purpose in the future. Additionally, it is recommended that the Ministry of Finance establish a uniform mechanism to define restrictions on the diversion of funds from capital funds for exceptional circumstances. It is further advised that the Budget Division refrain from employing capital fund resources to address fiscal challenges, such as the Cleanliness Fund, and instead pursue effective long-term alternative solutions.

- The Accountant General's Division should enforce its requirement for prior approval to create extra-budgetary capital funds, in accordance with TAKAM Directive 2.2.9. Enforcement of this requirement will guarantee that extra-budgetary capital funds are only established when truly necessary, thus preventing their unnecessary formation. Additionally, it is recommended that the Accountant General's Division periodically evaluate the necessity of updating TAKAM Directive 2.2.9 and establish deadlines for conducting audits to ensure compliance with the directive.

- It is advised that the Accountant General's Division assess the need to determine the interest rate applicable to funds deposited in the deposit account at the Accountant General's Division, specifically concerning extra-budgetary capital funds and third-party deposits, and to regulate the principles governing this aspect. This is necessary to ensure that, when required, the funds of extra-budgetary capital funds and third-party deposits are readily available for realizing their intended purpose as defined in their incorporation documents. Furthermore, it is recommended that, in establishing the principles governing the interest rate applicable to the deposit of extra-budgetary capital funds, consideration be given to the financial objectives set for each fund and the government’s ability to influence both their scope and timing of deposits.

Balance of Capital Funds Presented in the Financial Statements, 2018–2023 (in Millions of NIS)*



According to the government's financial statements for 2023, processed by the Office of the State Comptroller.

* The data is presented according to the latest update in the financial statements. Some capital funds are not included in the financial statements in some years because they were classified differently or were established at a later date.

Summary

In 2023, the State of Israel recorded a net accounting deficit of approximately NIS 132 billion. This marks an increase of approximately NIS 203 billion in comparison to 2022, transitioning from a net accounting surplus of around NIS 71 billion to a net accounting deficit of approximately NIS 132 billion. The deficit in 2023 was attributed to an escalation in state expenditures relative to the previous year, notably including an increase of approximately NIS 24.9 billion in expenditures related to the "Iron Swords" War during the last quarter of 2023, alongside a decline in state revenues, particularly following a significant rise in state revenues in 2022.

The ramifications of the war were primarily illustrated through a decrease in the employment rate, a reduction in private spending, and a substantial rise in public spending, predominantly within the defense sector. From a monetary standpoint, inflation continued to trend downward towards the target range; However, on a fiscal level, a budget deficit exceeding the initially planned deficit was recorded. The acute increase in financing needs led to a marked rise in debt issuance during the last quarter of 2023. The "Iron Swords" War exerted a considerable adverse impact on the macroeconomic indicators of the State of Israel. The ongoing nature of the war, extending beyond the financial statement preparation date and the audit end date, is anticipated to further deteriorate these indicators and necessitates the implementation of a prudent fiscal policy led by the Ministry of Finance.

Government capital funds are established to manage specialized activities within the government by creating an accounting and budgetary distinction between these activities and the regular governmental functions. The establishment of such funds aims to achieve various objectives, including providing protection against potential financial losses in various scenarios, bridging multiyear timing discrepancies between income and expenditures for large systemic projects, concentrating financial resources to meet specific goals, and managing funds for the benefit of future generations. The validity and status of these capital funds are determined by the incorporation documents governing their establishment, which vary in terms of realization timing, purpose, and scope.

The Compensation Fund (Property Tax Fund) is a legally established and managed capital fund, intended to compensate for damages incurred due to hostilities. Over time, it has accumulated reserves, with a balance of NIS 17.7 billion at the onset of the war. Initially, the balances within the Compensation Fund were deemed sufficient to finance compensation payments as defined by the red track in the Compensation Fund Regulations of 1973. However, as the war persisted and the eligibility criteria were expanded through temporary orders, doubts emerged regarding the fund's capacity to meet the arising obligations within the existing accumulation framework without necessitating an increase.

Typically, funds deposited in capital funds are utilized by the government to cover current obligations, with corresponding liabilities recorded against such actions, thereby rendering capital funds nominal in nature. Consequently, a comprehensive understanding of the economic implications among the management of the Ministry of Finance, including the Minister of Finance, is essential. Preparedness for scenarios that may require meeting obligations for capital fund realization, particularly during emergencies, across multiple capital funds within a condensed timeframe, is imperative. This understanding is anticipated to aid in decision-making regarding the establishment of capital funds and the associated budgetary considerations.

The audit identified deficiencies in the regulation of capital fund characteristics that may impede the maintenance of their status and the fulfillment of their intended purposes over time. These deficiencies predominantly concern the methods of transferring surpluses and balances across fiscal years, ensuring the allocation of accumulated funds according to their designated purposes, and methods for preserving their real value. Additionally, the absence of a mutually agreed-upon framework between the Budget Division and the Accountant General's Division compromises the comprehensive presentation of information regarding capital funds and could lead to their inappropriate use as a means to circumvent the state budget without justification.

It is essential for the management of the Ministry of Finance, encompassing the Budget Division and the Accountant General's Division, to reassess the utilization of the funds' mechanism, its fulfilled needs, scope, and the significant increase in its application over the past decade. Furthermore, it is advisable for these divisions to collaborate in formulating a uniform framework for defining capital funds (both budgetary and extra-budgetary), as well as for their creation, characteristics, and coordination of information regarding their scope and ongoing monitoring, including full recording methods. Such a framework will enhance clarity, certainty, and reliability concerning the budgeting processes of capital funds and their recording in financial statements, ensuring their establishment in line with clear and transparent guidelines whenever necessary. The application of standard incorporation documents and the establishment of a uniform mechanism to define fund characteristics will support the establishment of capital funds only in warranted instances, prevent unnecessary establishment, and assist in ensuring that their objectives are achieved over time.