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**OMNIMAX INTERNATIONAL, INC.**

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Quito, April 23, 1987

Mr.  
Frank Almaguer  
USAID Mission Director  
Quito, Ecuador

Dear. Mr. Almaguer:

In accordance with our contract with the Agency for International Development, enclosed are two copies of our third semi-annual report on the project Fiscal Administration Development.

Yours truly,

  
William W. Newnam  
Executive Vice President

cc: 1 copy to: Mr. Michael Snyder  
Regional Contracting Officer  
USAID  
APO Miami 34031

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Bureau for Program and Policy Coordination  
(PPC/DIU)  
Agency for International Development  
Washington D.C. 20523

OMNIMAX INTERNATIONAL INC.

Contract Number: 518-0036-C-00-5063-00

Project Number: 518-0042

Project Title: FISCAL ADMINISTRATION DEVELOPMENT

3RD SEMIANNUAL REPORT ON ADVISORY SERVICE

October 1, 1986 - March 31, 1987

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## I SUSTANTIVE REPORT

### A. Project Status

#### 1. General

As we begin to approach the half-way mark, we have to acknowledge that the project is falling behind schedule. The schedule was an ambitious one, attempting to do in four years what had never been done anywhere before in a similar space of time. Was the original project design too ambitious in view of the developing-country milieu within which projects of this nature have to function? Based upon the experience of the last year and eight months since arrival of the first advisors, we would have to answer in the affirmative. However, this does not mean the project could not have met its originally targeted schedule, had all the assumptions made in the design been met. Of course for those of us who have worked in many countries and projects, we know that rarely, if ever, do many of the optimistic assumptions attain validity. In the case of Ecuador, perhaps unduly influenced by the extremely successful pilot project conducted in 1984, more was expected. The enthusiastic entry of the new Government in August, 1984, added even greater impetus to these expectations. They have not, however, materialized to the extent originally contemplated.

At this point it is clear, for example, that it is highly unlikely that the fully developed and decentralized computer processing system as contemplated in the project design can be met within the present time frame of the project. Also, while it is likely that the reorganization will be fully implemented within the project's time period, it is unlikely that it will be as firmly entrenched as desired, with all elements of the new organization functioning at optimum levels. We are approximately one year behind where we had hoped to be in both efforts. Prior reports and this one provide the reasons for this situation, but simply put it derives from the failure of the government of Ecuador to focus adequate attention and support to meeting project objectives on a more timely basis.

The above needs to be said, but it must be put in perspective so as not to lead to unduly pessimistic conclusions. Considerable progress is being made and so far the project can be seen as exhibiting considerable success.

The reorganization is in the process of implementation; studies have been completed that should lead to moving the computer processing toward fruition; considerable training of managers and technicians has been completed and a base established for a considerable extension of such training; new delinquent collections and returns filing programs as well as new and expanded audit programs have been introduced, and overall collections have increased at a highly satisfactory rate. All of this has been accomplished by a Government that has been increasingly beleaguered politically and that has had to contend with a colossal drop in petroleum prices as well as natural disasters. In view of the latter, we must face the probability that collections will not continue to increase at the same extremely high rate experienced during the past two years.

At the close of the period for the last semi-annual report, it was reported that the outstanding Minister of Finance, Dr. Albert Dahik, had been removed from office and a new Minister had not yet been named. On October 30 senior Domingo Cordovez, Subsecretary for Administration in the Ministry of Finance was named as the new Minister. He has continued the same excellent top management team in the Direccion General de Rentas.

Collections to date have been very gratifying. In 1985, collections of S/ 49.1 billions were 49.3 % over 1984 collections in current sucres and 19 % higher in constant sucres. This initial partial year of the project was aided to some extent by the carry over of programs put into place in the former pilot project as well as the renewed emphasis the present project engendered. Collections in 1986 were S/ 83.3 billion or 64.4 % over 1985 in current sucres and 32% in constant 1985 sucres. In terms of the base year 1984, collections in constant terms were 61% higher in 1986. In terms of the project goal, S/ 16.7 billion of the S/ 25 billion goal or 67.8% has been achieved as of the end of 1986. During the first two months of 1987, collections were 35% over 1986 in current sucres, showing a continuing increase, but so far at a lower rate of increase.

## 2. Revenue Generation Activities

### a. Improved Collections and Returns Compliance Systems

During this period the number of agentes tributarios increased back up to its authorized staffing of 50 as a result of internal reassignments. However, the additional 20 agentes tributarios that were expected to be financed out of AID project funds were not hired. With the release of

funds resulting from approval of the new organization for the DGR, other delays ensued in getting approval from the National Personnel Office. Finally, with the financial crisis brought on by the March 5th earthquake, the Minister has decided not to request approval for the new positions in the 1987 budget. However, he is expected to request that AID provide project funds for the whole of 1987 for the 20 positions with a commitment to have them transferred to the 1988 budget. There are sufficient funds in the project for this and we are hopeful it will be approved. With the present staffing, however, only three of the five regional Departamentos de Control Tributario, have been established, Norte, Austro and Litoral Central. On a happier note, the 3 months back pay problem mentioned in the prior report was resolved, with payment made in February from project loan funds.

Delinquent accounts collections for the year 1986 amounted to a total of S/ 1.4 billion, an average of S/ 166.7 million per month. Due to several factors, collections of delinquent accounts have been dropping and probably will continue to drop in the ensuing months for several reasons: (1) most collectible large accounts have been collected because priority was given to larger cases in the first months of the program, (2) the easier cases have been collected, leaving the harder or non-collectible cases in the inventory, and (3) time is being allocated to work delinquent sales tax returns. This could possibly be offset to some extent by the emergency program now under way (see below).

The delinquent returns program was expanded to include registered businesses which have never filed sales tax returns. Although 3000 notices were issued, programs were not recorded sufficiently to serve as an accurate tool for measuring results. Reports, possibly not reliable, indicate that a large majority of the delinquency notices were issued to taxpayers who could not be located, or to taxpayers who had already filed, but less than 10% filed returns due to the program. The amount of actual collections obtained could not be compiled for lack of information. This has been disappointing and certainly indicative of problems in program management. The newness of the program, shifts in personnel related to the reorganization and the delay in implementing the latter were contributing factors. However, it goes deeper than that and indicates once more the inadequacies in the management structure of the DGR, which we are trying to see improved through the reorganization process and its concomitant management training emphasis. But, it will be a long haul.

Progress has been modest toward the project goal of doubling the number of sales tax filers (Transacciones Mercantiles) and increasing by 50% the number of global income tax filers. In 1985 the number of global income tax filers was 176,800, up by 9100 or 5.4% from the 167,700 filing in 1984 (the base year). A count is not yet available for the number of returns filed in 1986. Because of widespread evasion, emphasis has been placed on improving sales tax compliance. It is difficult to measure the results from this emphasis since it has been impossible to establish a reasonably firm base prior to 1985. In 1986, 33,600 filers were registered, 5400 or 19% over the 28,200 filers in 1985. We can assume, but not prove, that projecting back to the base year 1984 would show a greater increase toward the goal.

Under the reorganization the two new departments under the Subdirección General de Control Tributario, Programación y Control and Normas y Técnicas slowly came into operation. Work plans have been prepared, submitted and approved and work on new procedural manuals begun. Included in the latter will be improved enforced collection procedures at the Provincial and Regional levels, as a result of studies completed during this period. Broader statistics are being compiled to establish an improved base from which program needs and progress can be measured. An early effort will be made to develop a better reporting system and to see that it is fully followed so that programs can be adequately evaluated.

The Ministry ordered that only 50% of the staff located in the Dirección General de Rentas building should be present because of earthquake damage. An emergency program of alternating days was developed and implemented to utilize this staff in a city-wide canvas to verify that taxpayers are registered as businesses and are filing returns. Additionally, the Agentes Tributarios in all areas were instructed to concentrate on delinquent accounts (titulos de credito) regardless of value or source. The program was implemented the last week of March 1987. Both aspects of the program are geared to increase revenue collections to relieve the financial crisis caused by the broken oil line that stopped oil exports. Additionally, the masterfile (RUC) will receive information from the program to register new taxpayers, address and/or activity changes and business deaths, etc.

b. Improved Audit System

Progress continued in improving the audit system, although at a slower pace than had been hoped for. Here

again, the delay in reorganization had its impact on reaching desired goals.

The Subdirección General de Determinación Tributaria (National Audit Division) has only its Programming and Control Department functioning. The Normas y Procedimientos Department is staffed and ready to move to its designated quarters in April. The Departamento de Programación y Control has prepared its first national audit plan for FY87 - 88. Selection of returns was made by number and grade of auditors in each region after extensive consultations with regional audit chiefs. The National Office concept was further strengthened by extending the visitation program to monitor established projects, such as a program to identify purveyors to government institutions.

A decision by the Director General that Transacciones Mercantiles (Sales Tax) returns could be audited and the cases closed without auditing the concurrent income tax returns has cleared the way for the development of the recommended special audit program to increase coverage and provide some degree of compliance in this crucial area.

The instructors manual for the standard audit course has been delivered to the Ministry of Finance National Training Center for reproduction. The Departamento de Programación y Control is coordinating with the National Training Center and Regional Audit Chiefs for scheduling of this course. Since the course was developed to standardize procedures and improve audit techniques on a national level, it is planned to have all auditors receive the training as soon as practical.

The computerized audit time reporting system is not installed and functioning because the micro computers have not yet arrived, and because of constant changes in how data was to be entered on the originating document by the auditors. This has now been resolved and the monthly report form redesigned and approved. Instructions on its use will be issued during a visitation program by the Departamento de Programación y Control in April.

There has been a continued improvement in the number of taxpayers audited, deficiencies assessed and in unappealed cases. In 1986, 5,974 taxpayers were audited compared to 3,445 in 1984, with deficiencies assessed totalling S/ 4.57 billion compared to S/ 2.35 billion, and the amount of unappealed cases totalling S/ 2.1 billion compared to 1.2 billion. Using 1984 as the base year, movement toward the goal of doubling the number of taxpayers audited has been brisk, with 86.7% of the goal already having been met. The

average amount of unappealed cases of S/ 5.3 million while showing a significant increase of 62.3% in current sucre production over the 1984 average of S/ 3.3 million, remained static in constant 1984 sucres. The gain registered was offset practically entirely by inflation, registering only S/ 3.4 billion after applying the deflation index. Programs aimed at broader coverage have had an impact on increasing the number of cases audited, but have not yet yielded the desired increase in money production. The former is, of course, more important in providing an impact on increasing overall compliance.

### 3. Organizational Improvement Activities

#### a. DGR Reorganization

On October 9, 1986, the new organizational structure was published in the Registro Oficial, giving it the full force of law. With the return of the Director General and principal Subdirector General from the management course in the United States later that month, steps were immediately initiated to begin implementation of the new organization. At the same time, with the satisfaction of the condition precedent of the Project Agreement efforts were begun with USAID to step-up activities toward acquisition of equipment ordered long ago but held up by the suspension of funds.

Unfortunately, the early phases of implementing the reorganization did not proceed as rapidly as had been planned. This was due to (1) the obviously difficult problem of selecting and reassigning personnel within the new structure (2) relocating personnel within extremely limited office space and (3) the long delay in getting Ministerial approval of the proposed personnel assignments.

However during the period of this report, progress was made and the 1st phase of the reorganization, the establishment of the National Office, is essentially completed (although, of course, well behind the schedule originally planned). To prepare the new Department Chiefs and their initially selected staffs for their new role in the new National Office structure, a series of seminars were conducted. Initially a one day seminar was given to all department chiefs and subdirectors general, which covered a thorough review of the new organizational structure, the plan for implementation, a view of each individual's responsibilities, a discussion of the kind of activities and projects that each must begin to undertake, and general guidelines on developing functional management activities. Handouts for the participants were provided for the areas covered. Subsequently, each Department Chief, with the

assistance of the advisors, gave the same seminar to the personnel of his Department. Through this process, over 100 officials and technicians at the national level were reached. Subsequent sessions were conducted in each principal function as reinforcement and to move the reorganization process along. Also during this period the new departments began the planning process for 1987 programs, still initiated under the former mode since the departments were groping along in their early stage of formation.

At this point, the regions also are partially reorganized, which was planned as phase II of the implementation. Early in the phase I implementation, visits were made to the various proto regions to initiate implementation there. This did not follow the original plan and, in fact, made the implementation somewhat chaotic. However, this is the nature of the Ecuadorian reality and although it contributed to slowing down the completion of phase I, we can now take advantage of being somewhat down the road in phase II.

#### b. Restructured Processing Systems

The Systems Department in the reprogramming of the Transacciones Mercantiles system has finally overcome a steep learning curve involving the new UNIX mini-computer employed in the new Transacciones Mercantiles system in use of UNIFY, a relational data base, the C language, and various UNIX utilities. All programs have been converted and tested and actual production will begin in April with the NCR 9100 mini computer being released shortly after. While progress in programming was unexpectedly slow, the tools and techniques learned during this period will form a basis for all future programming efforts.

Additional UNIX applications under design are the Cashier system for Pichincha and the Secretaria General's office procedures. The Secretaria applications will be installed on micro computers but using an UNIX environment.

The overall system design and equipment specifications for the regional computer centers is in draft form. The specifications will reflect a continued commitment to the UNIX environment in the regional centers as throughout all of the DGR mechanization program. Until the design and specifications move forward, delay will continue in getting to the implementation stage of the decentralized computer processing system. With the new Systems Department now more firmly organized under the reorganization we hope that we can begin to see greater progress.

The Ministry of Finance's Direccion de Organizacion y Sistemas replaced their older IBM central computer with a new IBM 4381 model 12. The new computer, some two to three times faster than the previous model, will be used to support additional applications in the Customs agency, although all DGR applications presently using the central computer will benefit from the increase in performance. Dos's Systems and Programming Department, however, has given priority to reprogramming the data entry portion of the income tax returns processing rather than the installation of the new RUC system. The new RUC system is in danger of being abandoned if not given the proper attention.

The Pilot Project for the Cashier system in Pichincha could not be completed because of the lack of micro computers for testing and installation. The unanticipated delays in purchasing and delivery of the micro computers to the DGR was caused principally by the Ministry of Finance delay in the reorganization and in USAID's cumbersome procurement procedures. This means that word processors and micro computers expected in the DGR in November or December 1986, will not be delivered until June or July 1987. Several software and hardware orders either cancelled or delayed have further complicated the delivery of functioning equipment.

Another factor causing delays in the processing area is that of human resources. The Subdireccion de Procesamiento y Recaudacion, newly established under the reorganization, has had an acting Subdirector General named only very recently. Consequently, overall direction has been lacking or inconsistent at best. The Departments of Programacion y Control and Sistemas are understaffed both technically and numerically. Four college students on temporary assignments as data entry personnel, but project trained as UNIX programmers, were not rehired at contract expiration on January 1987. It appears that the National Director of Personnel withheld approval in retaliation for the recent dismissal of his brother from the DGR's Audit Department. This has reduced the programming staff in half at the very time the DGR needs to build this area for the near future.

#### 4. Training

Fifty one audit personnel in Guayaquil, including all supervisors and upper grade auditors, attended an 8 hour managerial seminar based on the six Peter Drucker video tapes. This was an extension to Guayaquil of the same seminar given in Quito during the last reporting period.

A group composed of the Director General, Subdirector General, Tecnico, Project Coordinator and the Chief of Party visited the Interamerican Center of Tax Administrators (C.I.A.T.) in Panama to explore areas in which C.I.A.T. could collaborate with the D.G.R. complementary to the efforts of the advisory team, especially in the area of training. C.I.A.T. presented proposals for several courses, from which two were selected: Auditing of Companies Utilizing Computer Systems and General Tax Administration. Plans are underway to utilize the latter course which will be given for two weeks in Panama and will be funded from project grant funds for which a waiver is needed and is now being sought.

7 programmers received 2 weeks training in the UNIX operating system and the C language (however 4 of these were not rehired after contract expiration in January, see Restructured Processing System).

10 programmers and system personnel attended a three weeks course in the UNIFY data base system including interface using the C language (again the same 4 programmers mentioned above were not rehired after their January expiration date).

The standard audit course was completed and classes for auditors are schedule to begin in Guayaquil and Quito the latter part of April 1987.

Seminars were conducted for all department chiefs and their staffs, providing orientation in their new functions under the reorganization, reaching over 100 key personnel.

A two day management seminar was given to 17 officials who have been selected for key positions at the National and Regional levels of the new organization. The seminar was shortened from the three days that had been utilized for past seminars since many participants had attended other seminars in connection with the reorganization and it was felt that some of the material would be repetitious.

The same group of 17 participants left on March 29 for a 4 weeks I.R.S. management course in the United States which will include 2 weeks in Miami and 2 weeks in Phoenix, Arizona.

B. Plans for the Next Six Month Period

1. General

Collections for this first 8 months of 1987 (through August) are expected to reach S/ 73 billion or 36% over the same period in 1986. In constant terms an additional S/ 20 billion will have been collected over the base year of 1984, resulting in 80% of the project goal of S/ 25 billion being achieved.

2. Revenue Collection Activities

a. Improved Collection and Returns Compliance Systems

20 new agentes tributarios will be recruited and trained.

A basic procedural manual for "Control Tributario" will be completed.

Improved reporting for the function will be developed and implemented

The remaining two Regional Departamentos de Control Tributario (Centro and Manabi) will be established and functioning within the pattern of the new organizational structure.

b. Improved Audit System

The Normas y Procedimientos Department, installed and functioning.

Audit program in Transacciones Mercantiles developed and implemented.

Computerized audit time reporting system installed and functioning.

Review Sections operational in the three major Regional Audit Departments.

Office audit function operational in the three major Regional Audit Departments.

### 3. Organizational Improvement Activities

#### a. D.G.R. Reorganization

The second phase of the reorganization, establishing the basic regional structure in all five regions, will be implemented.

Phase three of the reorganization, which includes the studies preliminary to beginning the decentralization of processing operations to the Regions, will be completed.

#### b. Restructured Processing System

Depending on the availability of micro computers:

- Program and install the Cashier system in the Pichincha Jefatura and its agencies.
- Installation of 8 word processors in various departments in the D.G.R
- Program and install a document control system for the General Secretary area for control of claims, correspondence and other documents.

Specifications for the regional computer centers should be published and procurement initiated.

#### c. Professional Inspection Service

Initial development of new concepts and program will be completed.

#### d. Public Relations Program

Development of improved public relations and information programs will be initiated.

### 4. Training

A management seminar will be conducted for an additional 15 key regional and national personnel to support continuing implementation of the reorganization.

The 15 key regional and national personnel will follow-up the seminar by attendance at the 4 weeks management course given in the United States by the U.S. Internal Revenue Service.

A seminar on processing systems will be conducted for 5 regional processing chiefs and several key national processing personnel.

80 journeymen level tax auditors will receive the 60 hour standard basic course recently developed. Instructors for the course will be selected from the instructors cadre that developed the course.

15 personnel from the new functional processing departments will receive a 40 hour course in organization and methods.

16 technical personnel from the several functional areas will attend the tax administration course given by C.I.A.T. in Panama.

## II. ADMINISTRATIVE REPORT

### A. EXPENDITURES

<u>Category</u>	<u>Budget Amount</u>	<u>Expenditures to Date</u>
Salaries & Wages	\$1,559,775	\$ 537,333.59
Fringe Benefits	99,937	62,914.34
Administrative Costs	54,685	21,218.46
Differential Allow.	355,540	111,270.15
Travel & Transp.	373,084	109,274.91
Other Direct Costs	102,030	63,124.40
Profit or Fee	254,505	90,509.06
GRAND TOTAL	<u>\$2,799,556</u>	<u>\$ 995,644.91</u>

## B. PERSONNEL EMPLOYED

	<u>Work-Months</u>	
	<u>This Period</u>	<u>Accumulated to Date</u>
1. <u>Field</u>		
a. <u>Long Term Advisors</u>		
Chief of Party	6	19.5
Audit	6	16.5
Processing Systems	6	18.0
Delinquent Collections & Returns Compliance*	6	14.5*
Total Long Term	24	68.5
b. <u>Short Term Advisors</u>		
Delinquent Collections & Returns Compliance	2.5	2.5
Audit	0	3.25
Training	0	4.0
Management	0	.5
Total Short Term	2.5	10.25
c. <u>Local Hire Support</u>		
Secretary	6	19.0
Administrative Assistant	6	7.5
Total Local Hire	12	26.5
TOTAL FIELD	38.5	105.25
2. <u>Home Office Support</u>		
Company President	2.6	8.4
Vice President Planning & Budget	2.2	5.2
Secretary - Treasurer	-	2.2
Office Clerical Support	4.8	18.1
TOTAL HOME OFFICE	9.6	33.9
TOTAL PERSONNEL EMPLOYED	48	139.15

## LOGICAL FRAMEWORK

## OUTPUTS:

Progress to DateRevenue Administration

1. Improved collection system
    - Professional corps of 35 persons established in Yr. 2
    - 35 technicians trained by Yr. 3.
    - Improved collections procedures and managerial functions fully instituted by Yr. 5.
  2. Improved returns filing compliance system
    - Professional corps of 35 persons established in Yr. 2.
    - 35 technicians trained by Yr. 3.
    - New programs and managerial functions fully instituted by Yr. 4.
  3. Improved audit system
    - Selective office audit functions initiated by Yr. 3.
    - 100 technicians trained in audit procedures by Yr. 4.
    - Improved audit procedures and managerial functions fully instituted by Yr. 5.
- Corps of 25 established.
  - 25 trained in collection of delinquent accounts.
  - Delinquent accounts program developed and implemented.
  - Corps of 25 established
  - 25 trained in delinquent returns program.
  - Delinquent returns program developed and implemented.
  - 51 auditors of limited experience trained in elementary auditing techniques.
  - Third party information program implemented;
  - 30 auditors supervisors given limited motivational and managerial training.

Progress to DateOrganizational Improvement

1. Reorganization of DGR
  - Reorganization plan approved
  - Reorganization plan approved in Yr. 1.
  - New organizational structure in place by end of Yr. 3.
  - 60 executives and managers trained in-country by Yr. 2.
  - 110 managers given advanced U.S. training by Yr. 4.
2. Restructured processing system
  - Reorganization plan approved
  - Phase 1 of reorganization (establishing National Office) completed.
  - Phase 2 (establishing Regional Office) partially completed.
  - 52 executives and managers given management seminar.
  - 52 executives and managers given I.R.S. management course in U.S.
3. Professional inspection service
  - Integrated master file processing system in DOS completed by end of Yr. 4.
  - 30 technicians trained by Yr.4.
  - Upgraded mini-computer (TOWER) performing limited processing for DGR.
  - Initial overall system design for decentralized system completed
  - 8 computer technicians have received 2 weeks course in Unix operating System.
4. Public relation program
  - Unit established and staff of about 20 in place in Yr. 3.
  - Program and procedures instituted in Yr. 3.
  - Department of Control Administrativo established and preliminary staffing and development underway.
5. Public relation program
  - Unit established in DGR for developing instructional materials and publications.
  - Effective media techniques and identified by Yr. 3.
  - Departamento de Difusión y Publicaciones Técnicas established and preliminary staffing and program development underway.

Progress to DateStudies

## 1. Revised procedural laws

- Study and recommendations for revised revenue code and procedural tax laws completed and approved by Yr. 2.

No action to date.

Note: In addition to the above, other brief training has been conducted, in furthering the reorganization implementation and improving tax administration programs:

- 5 executives attended the annual assembly of the Interamerican Center of Tax Administration (C.I.A.T.)
- 19 auditors were given instructor and development training to serve as the beginning of an instructor corps for the audit function.
- 90 supervisors and potential supervisors in the audit function were given an 8 hour management seminar using a series of 6 Peter Drucker VCR tapes.
- 12 supervisors in the delinquent collection and returns compliance area were given short seminars covering their supervisory responsibilities.