

**MID-TERM EVALUATION**

**ECUADOR**

**FISCAL ADMINISTRATION DEVELOPMENT PROJECT**

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## GLOSSARY

### FREQUENTLY USED TERMS AND ABBREVIATIONS

Renta:	Income Tax
Transacciones Mercantiles:	Sales Tax
RUC:	Master Register of Taxpayers
DOS:	Direccion Org. y Sistemas, Office of Organization and Systems (has mainframe computer)
Codigo Tributario	Tax Code and Regulations
Titulos de Credito:	Notice of Amount of Tax Owed
DGR:	Directory General of Revenues
Agentes Tributarios:	Professional Collection Corps (Collection Agents)
Retenciones:	Withholdings
IESS:	Ecuadorian Institute of Social Security
MOF:	Ministry of Finance
PP:	Project Paper

## INTRODUCTION

This mid-term evaluation is being carried out as provided for in the basic documents which authorized and established the project. The Project Paper, authorized December 18, 1984, states:

"Major evaluations will be carried out during the third and the final years of the project."

"The first evaluation will be a formative evaluation which will focus on how the project is being implemented. In this evaluation, primary attention will be devoted to the timeliness of input delivery and the effectiveness of the technical assistance and training. Baseline data on personnel skills and attitudes collected by the training coordinator will facilitate this evaluation. Progress-to-date in achieving outputs will be measured against the project implementation schedule. Finally, this evaluation will assess the prospects that the project will achieve the programmed outputs, subpurpose, and purpose, and will recommend any necessary changes to increase the likelihood of project success."

The present project, 518-0042, grew out of an earlier USAID Ministry of Finance project in the tax field which began in August 1983 and was completed in January 1985. Officially designated Revenue Generation Project, it consisted of three pilot programs in Returns Filing Compliance, Delinquent Accounts and Tax Auditing and became known as the pilot project in taxation.

The new administration of the Government of Ecuador which came to power in August 1984 demonstrated interest in a tax program even before it was officially inaugurated. It initiated a dialogue with USAID in June 1984, familiarizing itself with the pilot effort and exploring the possibilities for further collaboration on a larger scale. The Minister-designate personally participated with AID and other GOE staff in the initial design of the project now under review.

By November 1984, a formal PP proposing the project was completed and submitted to Washington. It was approved December 18, 1984. The Project Loan and Grant Agreement between USAID and the GOE was signed March 29, 1985. In April, contract negotiations began between USAID and Omnimax International to provide technical and administrative assistance to the GOE in the implementation of the project. By July, a contract was signed. In August, a Chief of Party, designated by Omnimax, arrived in Quito. He was followed in September by an Audit Advisor and in October by a Processing Systems Advisor. Since then Omnimax has provided three or four long-term advisors on a continuing basis as well as short-term consultants.

In terms of project implementation, the initiation of work under the contract constitutes the beginning of project activities. Therefore year one began July 15, 1985; year two, July 15, 1986; etc. The project activity completion date is July 31, 1989. This mid-term evaluation, then, is being carried out at the end of year two.

The evaluation follows the format of the Project Paper, using, wherever possible, the same headings and terminology applied in the logical framework. The team found that the Project Paper had done a superior job of setting out both quantitative and qualitative goals and targets, so that it provides excellent benchmarks against which project progress can be measured. We have cited only two instances where project targets might be revised and only one instance of an internal inconsistency in the document (see procurement). In general, however, we found it to be an outstanding document upon which to base an evaluation.

## SUMMARY CONCLUSIONS AND RECOMMENDATIONS

The regular reporting on this project has placed a heavy emphasis on achieving the quantitative targets and goals established in the basic project documents. Viewed solely in these terms, the progress to date is impressive. The broad goal of a S/. 25 billion increase in tax revenue during the life of the project has exceeded 50% in the first two years; the number of sales tax returns have increased substantially and are in line with project targets; the increase in the number of audits is likely to exceed life of the project goals and the delinquent accounts program collected almost as much in the first year as had been projected for four years and has already far exceeded the targeted amount. This is a very good record, indeed. Only the filing of income tax returns is not up to the progress in other areas. Here, unfortunately, not only have there not been any gains, there has been a loss. While this cannot be attributed to the project, it will eventually have a profound effect on revenue collection if it is not corrected.

However, these quantitative targets do not tell the whole story. This evaluation report, while taking these indicators into account, concentrates on the progress made in each one of the project elements to see whether the long-term institutional goals of the project are being achieved.

One of the outstanding project activity successes has been the Improved Collection System. It has registered both institutional and operational achievements. A Professional Corps of Collection Agents has been formed. Seventy agents were trained, fifty were hired and are at work. Plans are underway to hire twenty more. This achievement far surpasses the stated goal of 35 agents trained and working by year 3 of the project. This project element has also done well on increasing revenue collections, far exceeding financial analysis assumptions in the Project Paper (i.e., \$300 million increase over the life of the project). Collections in 1986 reached \$1.303 million. Even discounting for inflation, this is dramatic and can be attributed in large part to the initiation of Collection Agent activities. Also, there has been substantial movement in the right direction to achieving the project target of a reduction of the ratio of delinquent accounts to total collections to 10% by year 4. It has already dropped from 18% to 14%. However, this movement was not due primarily to project activity but rather to the effects of the increase in sales tax from 6% to 10%.

The record for improving Returns Filing Compliance is not quite so encouraging. Nonfiling is one of the most important sources of tax-evasion in Ecuador. Improving compliance would therefore represent a large increase in revenues on a continuing basis. There has been established within the DGR a well-defined function to deal with delinquent accounts and identification of non-filers. To date, two programs to identify stop-filers and non-filers have been undertaken. Both of them were well-conceived and well-planned. Unfortunately, poor control of information processed rendered the two programs ineffective. However, the foundations are in place for them to be repeated. Much more disappointing, however, is the fact that no program has been started or even planned for withholding agents and income tax in general. The delay in procurement of computer hardware is a reasonable excuse for not beginning these programs. But it is harder to find an excuse for not planning them.

The increase in income tax filers from 1984 to 1985 is only 5.4% probably not significantly different from normal average growth. Numbers from 1986 are not yet available. However, on the basis of the 1985 figures, the prospects for reaching the target of a 50% increase over the life of the project appear remote. For sales tax there was a 19% increase, reflecting to some extent earlier pilot project activities. However, even here a considerable acceleration will be required to meet the target of 100% increase by the end of year 4.

The Project Paper recognizes the crucial function of an Improved Audit System in the tax enforcement program. Progress in this area, during the first two years, has been uneven. It has been faster in training and organizational areas and slower in the operational area. It has been quite successful in improving the technical skills of the audit corps. Thirty-two more auditors have been trained than the 100 initially contemplated in the Project Paper. Actually, there are now plans to train all auditors in the DGR. This will be possible without additional resources because 19 senior auditors have been trained as instructors. This activity area is ahead of schedule.

Because of an initial delay in the reorganization of the DGR (see Reorganization, below), the planning and control functions of the audit system are still being put in place. The reorganization of the Central Office is complete, but the Regional Offices are still in varying stages of reorganization. Quito and Guayaquil will be partially operational within the next year. However, given the strong dependency

of the decentralization of the system on computerized processing, and the delays anticipated here, it is unlikely that the new structure of the audit office will be fully operational in the next two years.

In terms of audit coverage, the program is doing well. Three-quarters of the target of an increase of 100% in number of taxpayers audited has been met in two years. However, a new system for classification and selection of returns to be audited has not been introduced for lack of data: two special programs to target potential evaders were initiated but allowed to lapse; a third specialized audit program is being considered, but has not been implemented. Also, performance in the quality aspect of the program, measured by unappealed audits per auditors, has been lagging. One problem here appears to be that the target is unreachable as stated. We recommend changing it.

One of the major objectives of the project, the Reorganization of the DGR, got off to a slow start because of hesitation and reservations by the Minister of Finance. Because of this delay, the USAID suspended disbursement of funds to the project in March 1986, since reorganization was a condition precedent to disbursement in the second year of the project. The document authorizing the reorganization was not published in the Official Register until October 9, 1986. This delay put the entire project behind schedule by six-to-nine months. Once the reorganization plan was official, the DGR took immediate steps to implement it and most of the reorganization of the DGR Central Office, phase one, was complete by April 1987. Phase two, the reorganization of the Regional Offices is underway, but is being delayed because the procurement of computers is behind schedule. The final phase of processing returns in all Regional and Area Offices is not likely to be in place until a year or two after the project completion date.

Motivation and support for the reorganization is high among DGR personnel both in the Central Office and at the regional level. The new organizational structure is much more functional and makes much more sense in terms of the basic requirements of the administration of the tax system. The Project Coordinator is especially vigorous in pursuing reorganization goals. One large and serious obstacle to achieving the full reorganization goal is the lack of space in the DGR and in other offices in the system. The MOF must resolve this problem if it expects the DGR to operate effectively.

Perhaps the most ambitious element in this project is the plan for a Restructured Processing System. It embodies complete computerization and decentralization of tax return processing. If it is accomplished, it will give Ecuador one of the most advanced systems of tax return processing on the continent. However, it is at least one year behind schedule and will not be completely in place by the end of the project. The Project Paper underestimated the time and resources needed to complete the task. Serious delays in procurement coupled with an eight-month suspension of funding (see above) have made it impossible to complete this project element within its allotted time frame. Unfortunately, most of the other project activities are also dependent upon computerization, so that the project as a whole will not be able to achieve its goals until the actions contemplated under this project element are successfully completed. The serious delay in this element poses some immediate questions for USAID.

Will the project be extended so that the original project plan can be completed? If not, should there be a retrenchment in present plans to establish priorities in terms of revenue raising potential and the allocation of available resources? We address both of these alternatives.

Two other objectives under the reorganization plan were the formation of a Professional Inspection Service and the establishment of a Department of Information. Though both were delayed because of the overall reorganization delay, both have been established and are functioning. With regard to the Inspection Service, reorganization is proceeding, but is from six-to-nine months behind schedule. The Contractor has not been able to secure appropriate short-term technical assistance to design and help initiate the activities of the unit. This is a continuing problem which is impeding the full implementation of this project element.

Even though the DGR Department of Information is a functioning entity, it has not yet focused on the objectives described in the PP which emphasizes a public relations program capable of changing taxpayer attitudes. While the reorganization has succeeded in bringing together public information and technical publications in a rational manner, it has not established an entity which can provide leadership in developing a public information program for the general public.

Because of the central role that computer equipment plays in this project, the evaluators decided that the procurement problems experienced by the project to date be examined in some detail. While the procurement delays have not been responsible for bringing the project to a halt, they have contributed to the project being behind schedule. Unlike other project elements, full responsibility for procurement is assigned to USAID. It is ironic that the very action which the Project Paper anticipated would avoid delays, i.e., shifting procurement responsibility to AID, has actually contributed to delays. This is likely to continue until USAID focuses on the problem and organizes itself to overcome it.

The Project Paper also provided that four studies would be undertaken by the project. The first, Revised Procedural Laws and Regulations was to be undertaken by the Ministry of Finance. The other three, the USAID would contract out. The three studies under USAID responsibility were completed on schedule. The MOF study has not yet been started. The three USAID contracted studies have been made available to the MOF, but no action has been taken on them.

The final project element, General Advisory support, has been provided by the project Contractor, Omnimax, Inc. It has been at a uniformly high level. The Contractor and staff are located in the DGR offices, have established an easy working relationship with their counterparts and have the full confidence of the Director General and his staff.

## Recommendations

### Project Goal and Purpose

- a. The language of log-frame project purpose target should be revised, deleting the phrase, over and above what would be expected in the absence of the project. The target is simply a S/. 25 billion increase in revenue collections over the life of the project. This takes into account natural growth in the economy and natural growth in revenues as well as growth attributable to the project.
- b. In view of the lack of progress in increasing the number of income tax returns filed, additional emphasis should be given to this in the last two years of the project.

- c. Project monitoring should include progress made in each one of the project elements as well as that registered by the project's quantitative indicators.

#### Improved Collection System

- a. The DGR should continue to expand its Professional Corps of Collection Agents. Provision should be made to include at least 20 additional agents in the 1988 MOF budget.
- b. The practical difficulties that taxpayers have in making partial payments of their outstanding debt should be solved. To do this, the commissions system on Cobranza Coactiva should be reformed. The possibility of basing the commissions on the total amount of the taxpayer's outstanding debt, regardless whether or not a partial payment has been made, should be considered as a potential solution to this problem.

#### Improved Returns Filing Compliance

- a. As soon as communication between the old NCR and new Tower mini-computer at DGR is possible, the stop-filers program for Sales Tax should be reimplemented. It is very important for institutionalization that this type of program becomes routine before the long-term advisors leave post.
- b. At the present time there is no clearly defined responsibility within DGR to clean and update the RUC. A small office within the Subdireccion General de Procesamiento y Recaudacion should be created with the sole purpose of receiving and processing all information for the RUC.
- c. Once there is confidence that the RUC has been efficiently updated, the program to detect non-filers in Sales Taxes should be reimplemented. This program should also be part of the annual routine.
- d. DGR should not wait for the extra computer hardware to be installed to start planning a program to detect delinquent returns in Withholding. For example, third party information from the IESS could already be collected.

Ideally, special programs should also be planned to detect non-filers in income tax. Long-term advisors' expertise should be used to plan special programs for professionals and craftsmen. There is evidence that in those areas the number of nonfilers can be as large as the number of filers. For example, professionals who hold a private practice at the same time they are employed by a company or institution may not be declaring any income from their private practices.

- e. The Return Compliance Advisor should renew his efforts to persuade DGR to use third-party information in the Plan Emergente concentrating on the sales tax, income tax, and RUC.

#### Improved Audit System

- a. The DGR and the Audit Advisor should modify the overall quality target of this program element. The present target, measured in terms of unappealed assessment per auditor per year, will not be an effective instrument for monitoring future progress.
- b. To be able to develop new selection and classification procedures for the general audit programs, as well as for many other reasons, DGR should ask DOS to stop processing income tax returns of past years and start processing returns for 1986.
- c. The Audit Advisor and the OMNIMAX Chief of Party should take the lead in reintroducing and implementing the specialized audit programs using third-party information.
- d. Even though the training component of two elements of the project has been quite successful, continued educational efforts will be needed beyond the departure date of the present long-term audit advisor.
- e. The project team and DGR should consider decentralizing the audit function without waiting for the full computerized processing system to be in operation.

- f. To complement the scheduled time- and quality-control programs for auditors, DGR should consider introducing an ethical behavior or honesty control program. This could be done within the newly-created internal Professional Inspection Program (see Professional Inspection Program -- below). A well-documented investigation of several unethical auditors, followed up by criminal suits under the Penal Code would probably go far to bring in more ethical behavior among auditors. This problem should not continue to be ignored. DGR will never be able to deal effectively with taxpayer dishonesty unless it deals with dishonesty within its own ranks.
- g. The MOF should give space and staffing priority to the office audit program.

#### Reorganization of DGR

- a. The staff of programmers in the Systems and Tax Procedures Department (Departamento de Sistemas y Procedimientos Tributarios) is not sufficient to carry out its tasks. As an immediate action, the staff should be increased to at least ten.
- b. The Director General should emphasize the importance of improved management techniques to the success of the reorganization and should insist on a strict application of Civil Service rules and regulations in the promotion and hiring of DGR supervisory staff.
- c. Before providing training in the U.S. or third countries, the DGR should get a firm commitment from those participating that they will continue to work for the DGR for at least one year after their return. This is especially important for management personnel.
- d. The lack of office space is slowing the reorganization and decentralization process. Steps for the acquisition of a new building in Quito should be speeded up.

## Restructured Processing System

a. Because there is little hope that this project element will be finished during the life of the project, and because of the considerable resources involved, this is the time for AID to consider the possibility of extending the project. If the answer to an extension is no, then AID, the Contractor, and DGR should immediately enter into negotiations to retrench in this program element and redirect committed resources to other elements of the project. The danger is that by the end of the project there will be a number of computer systems in place in Regional and Area Offices mostly to process what is now being done quite well at the Central DGR Offices: e.g. sales taxes.

If AID decides to extend the project, the following recommendations should be taken into account:

- b. The computerization and decentralization plan may be too sophisticated for the level of development of Ecuador and the economic resources available to DGR. Therefore, worst-scenario planning is needed to have back-up systems in case computer equipment at an increasing number of offices cannot be maintained or replaced. It is not enough to have two or three spare computer units. These, in time, will be used up. By then the whole project effort may revert to the situation in DGR before the project started. Manual back-up systems and emergency procedures should be an integral part of the decentralization program. They are likely to be needed.
- c. Programming priorities have not been followed. In particular, as in other aspects of the project, nothing seems to have been done about income tax and withholding returns. Planning and then programming for processing of income tax returns should be started at once (see next recommendation).
- d. The serious bottleneck in programming should be overcome. It is not realistic to try to implement this ambitious project element with inexperienced programmers. Short-term advisors (more than one) should be brought in as soon as possible. It would be a good idea to use loan funds to contract with local programmers on a piece-meal basis.

- e. The recruitment and training of programmers and system analysts of Regional and Area Offices should not be delayed. Past experience tells us that this will be a long road. USAID and the Contractor should emphasize once again to MOF the importance of including some slots in the next budget for these programmers and as well as for other processing personnel needed in the decentralization plan.

#### **Professional Inspection Service**

- a. The Contractor should continue its efforts to provide short-term technical assistance to the Department of Administrative control as well as to pursue alternative approaches.
- b. The MOF should take early steps to relieve DGR space problems in general and provide additional space for the newly organized administrative control staff.

#### **Public Relations**

- a. Now that the new Department of Information and Technical Publication is a reality, the DGR should strengthen it so that it can undertake the expanded functions spelled out in the PP and the Project Agreement. The Department staff needs both outside technical assistance and training to fulfill its functions. If it is now deemed impractical to contract with a local public relations firm to design a marketing strategy, the Contractor should bring in short-term consultants to help design the strategy and to help train the staff.

#### **Procurement**

- a. USAID should examine the manner in which it initiates and processes procurement actions as they relate to this project and take appropriate steps to assure that undue delays do not occur.
- b. The Mission Director should be apprised of the seriousness of the procurement problems affecting this project and prescribe remedial actions.

- c. The Project Officer should reach agreement with other USAID Officers regarding reasonable time for reviewing procurement documents, then establish a tight schedule for the processing of each PIO/C and alert the Mission Director when delays occur.
- d. Because the liberation of imported supplies and equipment from customs is fundamental not only to this project, but touches the effectiveness of practically all USAID activity, it must be addressed by the Mission Director and, if necessary, brought to the attention of the U.S. Ambassador. It is beyond the scope of this evaluation to suggest solutions to the problem. But it must be observed that until it is resolved, this project will operate at a heavy disadvantage.
- e. The Mission will have acted negligently unless it has assured itself ahead of time that it can obtain customs clearance in a timely fashion for the \$785,000 of computer equipment about to be ordered.

#### **Revised Procedural Laws and Regulations**

- a. The requirement under the Project Agreement that the MOF carry out a study of the tax code should be brought to the attention of the Minister of Finance. The USAID should take every opportunity to remind the Minister and ministry personnel of the importance of such a study.
- b. The DGR should begin to do internal studies of the tax code and to encourage the Minister to constitute a study commission to recommend changes in the code.

#### **Revenue Sensitivity Analysis**

- a. These studies are related to an eventual revision of the tax law and changes in the tax code and should be brought to the attention of whatever commission is named to study these matters.

## I. PROJECT GOAL AND PURPOSE

The Goal of the project as stated in the Project Paper, is to strengthen GOE capacity to finance equitable development on a sustained basis. The key indicator of Goal achievement is an increase in public sector investment to approximately 10 percent of GDP by 1990.

The project Purpose is to increase Central Government fiscal revenues, especially from the income and sales taxes. The target for purpose achievement is a net increase in non-petroleum revenues over the life of the project of 25 billion sucres (principally income and sales in constant 1983 terms) above and beyond what would have been expected in absence of the project.

The Subpurpose of the project is to strengthen the fiscal revenue administration capacity of the Central Government. As stated in the Project Paper, the success of this effort will depend on minimal personnel turnover in the MOF's revenue units and on the effectiveness of project-financed technical assistance and training in changing attitudes and improving skills of those personnel who will be responsible for institutionalizing the new administrative mechanisms.

The project Strategy is based on two major components: revenue administration and organizational improvements. The first attempts to reduce taxpayer noncompliance in the three major functional areas: delinquent accounts, nonfiling and under-reporting. The second component, other than its central activity of reorganization of the DGR, deals with returns processing, professional inspection (internal audit), and public relations.

A third and smaller component addresses four topics related to the MOF's fiscal administration responsibilities. These are: a study to examine deficiencies in the procedural laws and regulations which hinder collections and encourage taxpayer non-compliance, which must include recommendations for changes. A second study will analyze the possible effects of the existing tax rate structure on taxpayer incentives. Third, an analysis of the Central Government's revenue-sharing program to improve the development impact of those resources. And fourth, a study to develop recommendations for improved customs revenue administration.

#### A. GOAL ACHIEVEMENT

The Goal is to help investment achieve a level of 10 percent of the GDP by 1990. Considering that the Ecuadorian economy before the oil crisis, reached a level of 9.3 percent in 1981 (see Table 1), 10 percent does not seem an unattainable goal. However, due to both the oil crisis of the early 1980's and the pressure of an upward adjustment in minimum salaries on Central Government current expenditures, public investment had fallen in 1984 to about half of what it was in early 1981. Nevertheless, there were some signs of recovery in 1985, which coincided with the initiation of the project. For the second year, 1986, no statistics are available yet. Therefore, there is no statistical basis for determining a trend since the project began.

Also, taking into account Ecuador's new crisis in the oil exports due to the earthquake, it seems that the GOE may still have serious difficulties, during the next few years, to get back to the public investment levels of the early 1980's. The following evaluation of the performance of the three main revenue collection programs, which constitute the main purpose of the project may shed some light on prospects for increased revenues.

#### B. PURPOSE ACHIEVEMENT

The target is a net increase of 25 billion sucres in nonpetroleum tax revenues — mainly from income and sales taxes — over and above what would have been expected in absence of the project.

The PP Financial Analysis (Annex IV) estimated net additional revenues of S/. 19,198 billion in the fourth year as a result of the project. This was without including revenues due to a natural growth of the economy. It then projected this increase back over the four years of the project using three different growth rates. (See Table 2). The S/. 25 billion target was based on the most conservative (2% growth) of the three projections.

TABLE 1

PUBLIC INVESTMENT AS A PROPORTION OF THE GROSS DOMESTIC  
PRODUCT IN NOMINAL TERMS

(in thousands of sucres)

YEARS	GROSS DOMESTIC PRODUCT	PUBLIC SECTOR INVESTMENT <sup>a/</sup>	PERCENT SHARE IN GDP
1980	293,337	25,103	8.6
1981	348,662	32,276	9.3
1982	415,715	33,921	8.2
1983	560,271	36,776	6.6
1984	805,701	42,622	5.3
1985	1,147,907	79,549	6.9
1986	n.a.	n.a.	n.a.

n.a. = not available

<sup>a/</sup> Correspond to "Formación Bruta de Capital".SOURCE: Central Bank, Cuentas Nacionales  
del Ecuador: (1976-1985)

No. 8, (Quito: Central Bank, December 1986)

**TABLE 2**  
**NON-PETROLEUM TAX REVENUES:**  
**COMPARISON OF THE ACTUAL AND ESTIMATED GAINS FROM PROJECT**  
 (in millions of 1983 sucres)

YEARS	ACTUAL GAINS FROM THE PROJECT <sup>a/</sup>	ESTIMATED REVENUE GAINS FROM PROJECT Per Annex IV-A of Project Paper		
		WITH 2% GROWTH GDP	WITH 4% GROWTH GDP	WITH 6% GROWTH GDP
1984				
1985	2,349	879	895	911
1986	2,845	2,433	2,523	2,613
1987	667 <sup>b/</sup>	5,109	5,393	5,687
1988		9,546	10,259	11,009
1989		9,723	10,639	11,620
1985-89		27,690	27,709	31,840

<sup>a/</sup> See Table 3.

<sup>b/</sup> This figure refers to the months from January to June only.

SOURCE: Table 3, and USAID-Ecuador, Project Paper: Fiscal Administration Development, Annex IV-A.

To arrive at the additional revenues estimate, the PP made a number of assumptions including the following: (1) the number of non-filers submitting returns would increase by 50% for the global income tax (corporations and individuals) and 100% for the sales tax; (2) collections from delinquent accounts would increase recovery of S/. 300 million over the project's life, and (3) the indirect impact of the project would increase total tax revenues by 10% of the base year, i.e., S/. 2 billion.

The project target, as stated in the PP, of S/. 25 billion, over and above of the project, is somewhat confusing since it includes revenues resulting from a natural growth rate of 2% which presumably would occur with or without the project. Therefore, to state that a S/. 25 billion increase in revenues over the life of the project are over and above what would have been expected in absence of the project is misleading since it combines the estimated net additional revenues of S/. 9.198 billion in the fourth year of the project with an annual growth rate of 2%.

However, since this is the stated project purpose, all project reporting has been done using the S/. 25 billion figure and project progress has been measured in terms of reaching that goal. Therefore, this evaluation will use the same measure. Nevertheless, for comparison's sake we have also measured progress against net revenues based on figures prepared by the MOF, DGR Planning Department, which estimated revenue increases (1) as a result of the project and (2) without the project. The without-the-project projections take into account historical trends of natural growth in tax base and revenues from 1974 to 1984 (see Table 3).

**TABLE 3**  
**CENTRAL GOVERNMENT FISCAL REVENUES**  
**IN REAL TERMS<sup>a/</sup>**

(in thousands of sucres of 1983)

YEARS	TOTAL REVENUES	ADJUSTED <sup>c/</sup> REVENUES	REVENUE COLLECTION <sup>b/</sup>	
			WITHOUT PROJECT	ESTIMATES <sup>d/</sup> DUE TO THE PROJECT <sup>e/</sup>
1983	22,346,160.3	19,273,947	-	-
1984	25,196,290.9	21,609,852.8	20,712,810.1	-
1985	29,454,709.0	25,182,778.9	22,832,945.0	2,349,833.9
1986	40,577,614.0	31,734,526.2	28,889,057.3	2,845,468.9
1987 <sup>f/</sup>	21,174,915.1	17,188,283.3	16,521,176.1	667,107.2
<b>TOTAL:</b>			<b>6,756,452.5</b>	

a/ Deflated by the CPI published by the Central Bank.

b/ Does not include oil revenues and import taxes.

c/ These figures do not include "Transacciones Mercantiles" tax from import (collected by the Central Bank) on which DGR has no effect.

d/ Estimates are based on the historical trend since 1974. Tax revenues from individuals take into account the fiscal cost due the increase of the general deduction and the allowances which vary with the adjustments in the annual minimum salary. Tax revenues from business take into account the actual growth in the GDP. The estimates of sales taxes (Transacciones Mercantiles) are adjusted taking into account economic growth, and the increase in the tax rate.

e/ Is the difference between "Adjusted Revenues in Real Terms" minus the "Estimates Without the Project".

f/ Includes the months from January to June only.

Source: Ministry of Finance, DGR, Planning Department.

As can be seen in Table 3, total revenues reflect a growth of S/. 15 billion between 1984 and 1986 and a projected growth of an additional S/. 2 billion for 1987 (based on January to June collections of S/. 21 billion). Therefore, it can be concluded that revenue increases during the first two years of the project have been greater than those assumed in the PP financial analysis and have achieved more than 50% of the projected goal in its first two years. However, the 1987 January-to-June figures suggest a drop in total revenue collection for the year and a consequent drop in additional revenue. If this proves to be the case, the additional revenues for 1987 will fall well short of the S/. 5 billion assumed in the PP, and may signal a much slower growth of revenues in 1988 and 1989.

The estimates of revenue collection directly attributable to the project prepared by the DGR Planning Department (Table 3) shows similar results. Projections through 1987 show an increase of S/. 6.8 billion. Measured against the PP's expectation of S/. 9.198 billion, this is a net increase in revenues, discounting natural growth of 73.4% of the estimate. However, it also reflects the sharp fall-off in revenue collections in 1987.

To get some insight into possible project-related cause for the large increases in revenue during the first two years of the project and the apparent drop in the third year, we analyzed the performance of the various revenue programs (i.e., delinquent accounts, non-filing and underreporting).

#### Returns from Nonfilers

##### Income Tax

As can be seen in Table 4, the number of income tax returns from 1984 to 1985 has actually fallen - 0.1 percent. Apparently, this fall is due to the increase in the legal minimum salary which automatically raises the General Standard Deduction and the allowances, increasing the number of individuals who are tax-exempt, and reducing the number who file. Another reason is that the project has concentrated heavily on the sales tax. However, taking the filers of global income, which is the group of taxpayers on which the project may have

its greatest potential impact, the results indicate (see Table 4) that the increase in filers, from 1984 to 1985, has been 5.4 percent, in contrast to the target of 50 percent for the life of the project. With regard to the tax returns of 1986, these are filed in 1987, so to date, DGR does not have the total number of tax returns for this year.

#### Sales Tax ("Transacciones Mercantiles")

The number of tax returns of the sales tax (see Table 5) has increased by 45.2 percent in the two years of the project. This figure is in line with the target of 100 percent over the life of the project. It is worth noting that in the first year (1985) the number of tax returns jumped about 37 percent. That may explain the relatively high rise in revenues in the first year of the project.

However, it should be noted that if the target of 100 percent is measured not in terms of tax returns but in terms of taxpayers, the increase would not be as high. The PP states that the 100 percent target refers to taxpayers. However, it is felt in MOF that tax returns were the intended target, which apparently makes more sense in terms of new additional revenues. Unfortunately, MOF has no statistics on number of taxpayers for 1985 and 1986. Therefore, number of tax returns is used here as an indicator of progress.

#### Auditing of Tax Returns (Underreporting)

As shown in Table 6, the total number of audits increased by 73.4% by the second year of the project. This undoubtedly is a very good performance when comparing these results to the PP financial analysis assumptions of 50 percent increase over the life of the project. Also, the number of audits as of 1986 (second year) increased substantially more than the 2,000 additional sales tax audit cases assumed in the financial analysis as shown in Table 6. Also, the average amount audited per taxpayer increased from S/. 2,243.4 in 1983 to S/. 5,324.3 in 1986, which is in line with the target. It should be noted, however, that the PP does not specify whether the increase (up to S/. 4,000 per

TABLE 4

NUMBER OF INCOME TAX FILERS

YEARS <u>a/</u>	TOTAL <u>b/</u>	ADJUSTED <u>c/</u> %	TOTAL	%
1980	460,394	-	112,041	-
1981	481,086	4.5	118,536	5.8
1982	537,977	11.8	135,599	14.4
1983	625,626	16.3	161,411	19.0
1984	775,486	24.0	167,661	3.9
1985	774,593	-0.1	176,784	5.4
1986	n.a		n.a	

n.a = not available.

a/ The figures correspond to the year that income was earned.

b/ The total does not include tax exempt filers.

c/ These figures include Global Income only.

SOURCE: Ministry of Finance, General Directorate of Internal Revenues, Planning Department.

**TABLE 5**  
**NUMBER OF RETURNS OF SALES (TRANSACCIONES MERCANTILES)**  
**AND SERVICE TAXES**

YEARS	NUMBER OF TAX RETURNS	%	HISTORIC TREND <sup>d/</sup>	PROJECT (ADDITIONAL)
1980	79,825 <sup>a/</sup>	-		
1981	80,141 <sup>a/</sup>	-		
1982	82,946 <sup>b/</sup>	-		
1983	85,314 <sup>b/</sup>	-		
1984	87,903	-		
1985	120,423	36.9	90,540	29,883
1986	127,679 <sup>c/</sup>	45.2	93,256	34,423
<b>TOTAL</b>				<b>64,306</b>

a/ This figure is based on the assumption that the number of tax returns per taxpayer are 7 and 1.5 annually depending on the value of their registered capital.

b/ This figure is an estimate.

c/ Some additional tax returns may still be filed for this year.

d/ These figures were computed based on the historic trend of 5 percent annually.

SOURCE: Ministry of Finance.

**TABLE 6**  
**RESULTS OF THE AUDITING PROGRAM<sup>a/</sup>**  
(in thousands of sucres)

YEARS	VALUE OF AUDITS TOTAL	ADJUSTED TOTAL <sup>b/</sup>	NUMBER OF AUDITS	PERCENT INCREASE	NUMBER OF AUDITORS <sup>c/</sup>	AVERAGE AUDIT <sup>d/</sup>
1980	1,417,901.4	575,769.3	4,387	--	401	1,435.8
1981	1,417,102.0	663,010.8	3,987	—	375	1,768.0
1982	1,597,882.9	632,321.0	4,106	--	377	1,677.2
1983	1,687,417.1	778,463.1	3,714	--	347	2,243.4
1984	2,353,104.4	1,221,563.5	3,445	—	368	3,319.5
1985	3,765,188.4	1,453,643.5	4,429	28.6	365	3,982.6
1986	4,567,588.1	2,081,789.8	5,974	73.4	391	5,324.3
1987	2,754,389.1	n.a	1,638			

n.a. = not available

<sup>a/</sup> Includes income, sales, and other taxes.

<sup>b/</sup> Refers to the value of non-appealed audits.

<sup>c/</sup> Do not include supervisors.

<sup>d/</sup> It is the relationship between non-appealed audits and the number of auditors.

SOURCE: Ministry of Finance, General Directorate of Internal Revenue, Audit Department.

**TABLE 7**  
**DELINQUENT ACCOUNT COLLECTIONS a/**  
 (in thousand of sucres)

YEARS	BALANCE <u>b/</u> TOTAL	ADJUSTED <u>c/</u> FOR EXPIRATIONS	TOTAL COLLECTION	PERCENT SHARE IN TOTAL AND ADJUSTED BALANCE	
1984	4,781,353.9	3,586,015.4	309,118.0	6.5	8.6
1985	6,031,279.8	4,523,459.9	371,340.4	6.2	8.2
1986	9,212,048.5	6,909,036.4	1,303,554.2	14.2	18.9
1987 <u>d/</u>	-	-	329,451.8	-	-

a/ Refers to "Títulos de Credito Tributario Vencidos."

b/ Refers to the balance at the beginning of the corresponding year.

c/ Based on rough estimates, it is considered that approximately 25% percent of the "Títulos de Credito" have expired due to statute of limitations.

d/ Includes the months from January to June only.

SOURCE: Ministry of Finance, General Directorate of Revenues,  
 Subdirection of Tax Control.

audit) ought to be measured in real or nominal terms. A broader analysis of this particular target is taken up below (see Improved Audit System). Also, it should be kept in mind that some project targets established by the PP are higher than those used in the financial analysis. We will use the PP targets throughout for evaluation purposes.

#### Delinquent Accounts

As shown in Table 7, the Delinquent Accounts Program had by 1986 already exceeded the financial analysis assumptions of S/. 300 million over the life of the project. It collected in real terms over two and a half times the amount raised in 1984 and has, therefore, far surpassed PP expectations.

#### Voluntary Tax Compliance

The voluntary tax compliance assumption of the PP financial analysis, a S/. 2 billion increase over the life of the project, cannot be evaluated because the DGR has no statistics to measure it. There is no doubt, however, that an increase in voluntary compliance is closely related to the effectiveness of the overall collection system. In view of the delays in a number of enforcement and collection elements of the project, this assumption may be optimistic.

#### Conclusions

As stated above the quantitative target of S/. 25 billion increase, over and above what would be expected in the absence of the project is misleading and should be clarified. This could be done by deleting the underlined phrase from the log-frame target language.

The regular reporting on this project has placed a heavy emphasis on the quantitative targets discussed in this section. Viewed solely in these terms, the progress to date has been impressive. The broad goal of a S/. 25 billion increase in tax revenue during the life of the project has exceeded 50% in the first two years; the number of sales tax returns have increased substantially and are in line with project targets; the increase in the number of audits has already exceeded the life-of-the-project goals, and the delinquent accounts program has already collected far over the targeted amount. This is a very

good record, indeed. Only the performance of the filing of income tax returns is not up to the progress in other areas. Here, unfortunately, not only has there not been any gain, there has been a loss. While this loss cannot be attributed to the project, it could eventually have a profound impact on revenue collections, if not corrected.

Nevertheless, as important as these quantitative targets are as indicators of project progress, they do not tell the whole story and indeed might breed complacency if accepted without further examination. While the revenue increase performance to date is impressive and while this, in a sense, is the real measure of project success, it does not tell us whether or not the long-term institutional goals of the project are being achieved. It is the eventual achievement of those goals which will in the end ensure future increases in revenues and determine the ultimate success or failure of the project.

It is the opinion of the evaluators that too much emphasis has been placed on these quantitative indicators to judge project progress and that more attention must be paid to progress made in each one of the project activities to reach a judgement on project success. The rest of this evaluation report concentrates on this and will provide a series of observations and recommendations which can be used for monitoring project progress for the next two years.

Recommendations:

- a. The language of log-frame project purpose target should be revised, deleting the phrase, over and above what would be expected in the absence of the project. The target is simply a S/. 25 billion increase in revenue collections over the life of the project. This takes into account natural growth in the economy and natural growth in revenues as well as growth attributable to the project.
- b. In view of the lack of progress in increasing the number of income tax returns filed, additional emphasis should be given to this in the last two years of the project.
- c. Project monitoring should include progress made in each one of the project elements as well as that registered by the project's quantitative indicators.

## II. PROJECT ACTIVITIES

### A. REVENUE ADMINISTRATION

#### 1. Improved Collections System

This section refers to the improvements in the tax collection system that deals with taxpayers who file but do not pay, or make partial tax payments only - i.e., delinquent accounts. Section 2 will deal with potential taxpayers - i.e., non-filers.

#### Target:

Collections unit in DGR functioning efficiently to maintain value of delinquent accounts of not more than 10% of annual tax receipts.

#### Outputs and Major Activities:

- 1) Professional corps of 35 persons established in yr. 2; 35 trained by yr. 3.
- ii) Improved collections procedures and managerial functions fully instituted during the final 12 to 18 months of the project.

#### Inputs:

A long-term advisor, who will divide his time between collection activity and return compliance activity.

Loan funds may be used to cover up to six months of remuneration of personnel who may be newly hired for the Professional Collections Corps. The MOF will include funding for additional and upgraded personnel, production of manuals, forms, etc.

Status: As of July 31, 1987:

a. Target

The value of delinquent accounts, as a proportion of tax collection was reduced from 18 to 14 percent from 1985 to 1986. (See Table 8.)

Therefore, there is a favorable trend towards the attainment of the 10 percent target by the end of the project (1989).

b. Outputs and Major Activities

Seventy Collection Agents have been trained. Two courses for the agents were taught. The first course, of 180 hours, was given to the 70 agents. The second course was directed, for two weeks, toward 30 of the 70 agents.

Four different manuals have been produced, covering the areas of delinquent accounts, tax enforcement, and general administrative procedures.

Target Achievement

Total revenue collections increased from S/. 32 billion in 1984 to S/. 49 billion in 1985 and S/. 83 billion in 1986.

During the same period, the amount collected under delinquent accounts increased from S/. 309 million in 1984, to S/. 371 million in 1985, to S/. 1,303 million in 1986. The dramatic increase in the delinquent account collections in 1986 can be attributed in large part to the initiation of collection agent activities. Based on MOF statistics, the calculations show that in the first year of the project (1985), the proportion of delinquent accounts with respect to tax collections was 18 percent. In the second year, the latest with available information, the delinquent/collection ratio has dropped to 14 percent (see Table 8). Therefore, in terms of progress towards the achievement of the 10 percent target, there has been substantial movement in the right direction. However, it should be noted that this was not due primarily to project activity but rather to the effects of the increase of the sales tax rate from 6 to 10 percent in 1986.

TABLE 8

DELINQUENT ACCOUNTS AS A PROPORTION OF  
TOTAL NON-PETROLEUM TAX COLLECTIONS

(in thousands of sucres)

YEARS	TOTAL REVENUE COLLECTION	TOTAL DELINQUENT ACCOUNTS <u>b/</u>	DELINQUENT COLLECTION RATIO
1980	13,368,456.9	-	-
1981	16,134,625.2	-	-
1982	17,706,678.9	-	-
1983	22,346,160.3	4,781,353.9	0.21
1984	32,855,963.3	6,031,279.8	0.18
1985	49,159,909.3	9,212,048.5	0.18
1986	83,346,419.1	11,646,199.6	0.14
1987 <sup>a/</sup>	53,424,310.7	n.a.	n.a.

n.a. = not available

a/ This year covers the months from January to June only.

b/ These figures refer to the value of the inventory at the end of the period.

SOURCE: Ministry of Finance, General Directorate of Revenues,  
Subdirection of Tax Control.

### Output and Major Activities

To date the project has trained 70 professional collection agents (Agentes Tributarios). Fifty of them have been hired. In this regard, the Project Paper states that by the end of the second year 35 Collection Agents should be in place. Therefore, this activity has doubled its target in terms of trainees, and has exceeded by 42% the number of agents hired. AID, as agreed, funded part of the first group of agents until December 1986. Since January 1, 1987, fifty agents have been funded through the GOE budget. The DGR, taking into account the distribution of tax payers and volume of collections by region, has assigned the new professional collection corps mostly to the Regional Office of Pichincha and Guayas, and few of them to Cuenca y Manabi. The hiring of the remaining 20 agents has been pending for about a year, due to a refusal by the National Office of Personnel to approve the increase so they can be included under the GOE budget. USAID is considering providing loan funds to cover these new agents until the next budget year.

Four manuals have been produced by the Subdirection of Delinquent Accounts and Filing Compliance, taking into account the new organizational structure of DGR and the plans to decentralize it, together with the goal of improving tax collections.

1. The first manual on overdue taxes (Manual de Recuperacion de Valores Exigibles) describes the different activities of this process) identifies the public official or administrative unit responsible for each of the activities, indicates the forms to be used in each of the steps of information flow, and specifies the reporting and control mechanism for tax collection corps (e.g., "Agentes Tributarios").

The second manual (Manual de Control de Cumplimiento de las Obligaciones Tributarias) deals with the functions and procedures to handle non-filers and those taxpayers who have stopped filing. This manual, among other things, describes the steps and flow of information between DGR, the

regional and the local offices. It addresses the way to do the planning of collectors corps' activities and the follow-up of tax payers, it also establishes mechanism for control of collector corps.

The third manual (Manual de Asistencia Coactiva y Procedimientos Afines) covers the procedures in the case that payment of overdue taxes is not made. It describes the responsibilities in each step of the tax enforcement system, particularly within the new organization of DGR.

The fourth manual (Proyectos de Formularios e Instructivos) includes both the different forms and instructions to be used on the different aspects of the tax revenue administration.

All the above manuals are currently being discussed with the regional offices and some of the area offices. These manuals are still subject to the final approval of DGR Director.

With regard to training, Collection Agents have been given two courses: The first, with a duration of 180 hours was given to 70 applicants, and covered subjects such as the tax code, tax laws, tax determination, accounting, etc. This course took place in the months of June and August 1985. The second course was given only to the 30 who were selected for hiring. This course covered the areas of the collection process, the appropriate methods for contacting and dealing with taxpayers, human relations, investigative techniques, etc.

Interviews with some of the Collection Agents who attended these courses indicate that they believe that the study program was very helpful in preparing them for their new functions.

However, even with training, there are still problems in the collection system which can cause difficulties for the Collection Agents. Interviews with some of them indicated that one serious problem was that some of the Area Offices resisted accepting partial payment on outstanding taxes after the Collection Agents had convinced tax payers to

do so. The reason is that Area Offices, using a different legal instrument (cobranza coactiva), can earn a 3% commission for each collection they make in this way. If the taxpayer makes a partial payment, this precludes issuing the cobranza and the earning of the commission.

We brought this problem to the attention of the Sub-Director of Tax Control who indicated that he would look into it.

During the second year, the project was supposed to expand collections based on the pilot program "Titulos de Credito" (i.e., delinquent accounts). Given this purpose, the General Subdirection of Tax Control was supposed to upgrade the classification of delinquent accounts, dividing them into active cases, accounts in appeals status, accounts under installment payment agreements, small accounts not justifying collection costs, those for which the statute of limitations had expired, and accounts uncollectable due to lack of assets or inability to locate the taxpayer.

Each of the above classifications has been developed, except for the last (i.e., uncollectables), for which there exist some information but a complete file has not been produced. On the other hand, the studies on each of these particular accounts, which are supposed to improve procedures and programs in order to reduce or eliminate delinquency, have not been done.

With regard to the decentralization of the tax collection system, it is mostly based on the installation of the mini- and micro-computers in the regional and area offices respectively. Therefore, since the installation of these computers is at least one year behind, the decentralization of the system, unless some manual programs are implemented in the meantime, will not be able to be functioning as originally planned - i.e., by the middle of the third year.

### Conclusions:

This has been a particularly successful project activity which has already had a significant operational impact. The investment by the MOF in 50 Collections Agents has paid high returns in terms of increased revenues from delinquent accounts. It has demonstrated the wisdom of separating the audit functions from the collection function and created an effective collection mechanism which can be expanded to reach into all areas of the country. As mentioned above, there are plans to increase the corps to 70 in the near future. Based on past success, there is no reason to doubt that an increased number of Collection Agents will bring a proportional increase in delinquent account collections.

The results towards the achievement of the target of 10 percent also shows a significant improvement. However this result, unlike the delinquent account collections, is mostly due to the increase in the rate of the sales tax ("Transacciones Mercantiles") which increased 1986 collections substantially.

In terms of training, the project has accomplished more than the target originally set for the second year. Training of Collection Agents in particular, has made for a substantial improvement in DGR's internal collection capacity.

### Recommendations:

- a. The DGR should continue to expand its Professional Corps of Collection Agents. Provision should be made to include at least 20 additional agents in the 1988 MOF budget.
  
- b. The practical difficulties that taxpayers have in making partial payments of their outstanding debt should be solved. To do this, the commissions system on "Cobranza Coactiva" should be reformed. The possibility of basing the commissions on the total amount of the taxpayer's outstanding debt, regardless of whether or not a partial payment has been made, should be considered as a potential solution to this problem.

## 2. Improved Returns Filing Compliance System

### Targets:

- (i) A tax filing compliance function is clearly defined within DGR and is operating effectively to identify nonfilers.
- (ii) The number of global income tax and sales tax filers increased by 50 percent and 100 percent, respectively.

### Outputs and Major Activities:

- (i) Up to 70 agents of a Professional Collections and Corps (Agentes Tributarios) will be hired and trained in-country by year 2. Approximately 8 of these personnel will receive advanced training in the U.S. in year 3.
- (ii) Limited returns compliance programs will be undertaken using the new professional corps of collection agents with same timing as in (i) above. Investigation of stop-filers will be programmed using delinquency data on sales and withholding taxes generated by minicomputer at DGR.
- (iii) By middle of third year systematic field surveys will be undertaken to locate non-filers not included in RUC or other data sources accessed by DGR. By year 4 improved planning and control systems will also be installed.
- (iv) Effort to consolidate and fully institutionalize the improved returns compliance operations will be undertaken during the final 12 to 18 months of the project.

### Inputs:

- (i) A long-term (four years) advisor who will also work in the collections activity.

(ii) One or more short-term technical advisor who will also work in the collections activity.

(iii) Temporary Loan funding will be provided to pay new Collection Agents if necessary.

Status as of July 31, 1987:

a. Targets:

(i) A tax-filing-compliance function has been defined within DGR organizational structure: Subdireccion General de Control Tributario. Some programs to identify non-filers have been initiated, especially for sales tax, but they are not fully institutionalized.

(ii) Increase in the number of global income tax and sales tax filers.

	<u>1986</u>	<u>%increase</u>	<u>1985</u>	<u>%increase</u>	<u>1984</u>
Global income	-	-	176,800	5.4%	167,700
Sales tax	-	-	33,600	19%	28,200

b. Outputs and Major Activities:

(i) 50 new Collection Agents have been trained and have been at work since 1986. The hiring of 20 additional agents has been postponed because of administrative and budget difficulties. No advanced training in the U.S. has taken place yet.

(ii) As an extension of the pilot project, a sales tax delinquent returns program for taxpayers who stopped filing in 1985 was implemented in August 1986 for Pichincha and Guayas. Using DGR mini-computer files. A program for non-filers in sales tax was initiated in December 1986 in Pichincha and Guayas and in January 1987 in Azuay, using files from mini-computers at DGR and RUC information at DOS. Withholding taxes were not included in any of these programs.

(iii) Systematic canvassing program in search of non-filers was undertaken in Quito from March to July 1987. A similar program was initiated in late July 1987 for Guayaquil. This program was initiated in a hurry because of the availability of DGR personnel for field work due to the earthquake of March 7, 1987.

(iv) Input Usage: Long-term advisor Marion Coburn initiated his tour of two years in August 1986, Mr. Coburn was also a short-term advisor from November 1985 to March 1986. He designed a program to detect stop-filers in sales taxes. A second short-term advisor, Raymundo Villanueva (March-May 1986) helped with training and implementation and to finalize the project. A third short-term advisor Mike Lugo (January-July 1987) concentrated on collections.

Target Achievements:

Before the project was initiated, the audit office had as one of its functions to bring nonfilers into the tax net. Because of the marked reluctance by auditors to perform nonfiling compliance duties in the past, the project envisioned the creation of a new professional corps which would be in charge of filing compliance and collection of overdue payments. This was the right move, given the potentially large number of nonfilers documented in previous studies and the significant differences between the audit and filing compliance functions.

The objective of this project element, therefore, was to define a separate tax filing compliance function within DGR and make it operational in the lifetime of the project. As in some other elements of the project, progress to date has been uneven. In terms of organizational structure, this project element is doing well. A new Subdireccion General de Control Tributario was created and is headed by an energetic Subdirector. The Departamento de Normas y Tecnicas Tributarias of this Subdireccion has produced four good manuals in a short period of time (see Improved Collecting Systems above), and the Departamento de Programacion y Control, although with some staffing problems, also seems to be on the right track.

On the operational side, this project element is not doing as well. As we will see below in our discussion of output and major activities, a number of programs to identify nonfilers have been implemented. But these programs have been narrow in scope (sales tax only) and have produced disappointing results. It is not surprising, therefore, that the project element is so far behind its quantitative targets. The increase in income tax filers from 1984 to 1985 was 5.4 percent, probably not significantly different from the normal average growth. Figures from 1986 are not yet available, but unless there is a significant acceleration it seem unlikely that the target of 50 percent increase in income tax filers over the life of the project will be met. For sales tax, there was a 19 percent increase in filers from 1984 to 1985. This higher rate of growth reflects some of the pilot project efforts. Numbers for 1986 are not yet available, but a considerable acceleration will be needed to meet the target of 100 percent increase in the number of sales tax filers by the end of the project. Pending the number of new filers registered in 1986 for income and sales, it seems that a renewed effort on the delinquent returns program will be necessary even to get close to the target figures by the end of the project.

#### Outputs and Major Activities:

##### New Collection Agents

The first main activity area, hiring and training new Collection Agents for the delinquent accounts and returns office, has been the most successful. Fifty Collection Agents have been at work for over a year. They were initially paid, but not without some administrative problems, from loan funds, and they were integrated in the 1987 DGR budget. An attempt to integrate 20 extra Collection Agents in the 1988 budget failed. First, the director of National Personnel Office did not move to make the appointments official apparently in a vendetta because his brother had been one of the auditors fired in the reorganization of DGR. After the earthquake of March 5, 1987 and the fiscal crisis that followed, the Director General postponed the hiring of the 20 Collection Agents until next year. There have been discussions about paying the salaries of the 20 Collection Agents from loan funds. The in-country

training of Collection Agents appears to have been adequate and advanced training in the U.S. for a selected group of supervisors is being planned. With minor problems, this area of the project element is ahead of schedule.

#### Return Compliance Program

The second main activity area of the project element, the implementation of return compliance programs to identify stop-filers and nonfilers, has been less successful. Taking advantage of the fact that the sales tax returns for 1984 had been processed in the minicomputer at DGR during the pilot project, a program to identify stop-filers for 1985 was initiated in August 1986 for Pichincha and Guayas. The program was closed by December 1986 with very little success. Collections of only S/. 9 million were directly attributed to this program. There were 3,200 delinquent notices issued for Pichincha and 3,300 for Guayas. But apparently more than half of the notices were issued to taxpayers who had actually filed. Later it was found that a large number of sales returns for 1985 had never been processed. In addition, other returns had not been processed because there were no specific instructions about how to handle errors in the filed returns.

In spite of the problems experienced in the implementation of the program the first time around, this is a well thought-out program that should be permanently institutionalized and become routine for the yearly activities of DGR. The only practical difficulty now is that DGR has been waiting for a connecting cable that will allow the transfer of the Sales Tax files now in the old NCR mini-computer into the new Tower mini-computer.

#### Non-Filers of Sales Tax

A third Activity, to identify nonfilers of Sales Tax, was initiated in December 1986 in Pichincha and Guayas, and in January 1987 in Azuay. Information on businesses registered in the RUC maintained at DOS was crossed with information on actual files in the mini-computers files for Sales Tax at DGR. This program was again a failure. The reasons for this failure were multiple: lack of transportation or even funds for bus fares, etc. But the central flaw

of the program was the poor information extracted from the RUC files. Up to 90 percent of the notices issued were invalid because business had ceased operations, had changed address, etc. Those responsible for the implementation of the program at the Subdireccion General de Control Tributario reached the conclusion that any enforcement program based on the RUC was doomed to failure because the information was totally outdated. Other people that had worked on the RUC for years argued that there were fields in the RUC that never were used in the December 1986 program. The poor information produced in the August and December 1986 programs created some resentment and embarrassment among the Collection Agents, especially because the taxpayer notifications had been written in a strong accusatory tone. There is no information on revenues produced by this program.

Even though there were significant shortcomings, the December 1986 program for non-filers is a worthwhile program and should be repeated as soon as the RUC is cleaned up. Some efforts are underway to update the RUC, which are discussed below. (See Processing.) In summary, the stop filers and non-filers programs for sales taxes were failures, but there is hope that with better programming and control, these programs will be institutionalized as a routine enforcement exercise of DGR.

#### Income Tax Withholding

An area of more serious concern is income taxes and in particular the withholding system. This is an issue that has not been studied in Ecuador but there is a widespread belief that a large number of employers do not comply with withholding regulations either by not withholding at all, or withholding and not reporting, or reporting irregularly and only in partial amounts. The project had scheduled a parallel effort for delinquent returns in Sales Tax and retenciones (withholdings). While significant progress has been made with the Sales Tax, to date nothing has been done in withholdings or any other aspect of non-filing of income taxes. In this element of the project, nothing is being done to reinforce compliance on income taxes. Operationally, the reason for inaction in the area of withholdings is that none of the information has been processed at the DGR mini-computer. We did not find any concrete plans for

processing that information either. As a result this main activity of the project element is significantly behind schedule.

#### Field Survey to Locate Non-Filers

The fifth activity area of this project element consists in developing by the third year of the project systematic field-surveys to locate nonfilers for different taxes as well as to update information for DGR, including RUC. An Act of God, the earthquake of March 5th, 1987, put his area of the project ahead of schedule even if it began in a haphazard way. After the quake the DGR building was inspected for damage. The building was found to be only slightly damaged but to be holding a deadweight that was a much higher multiple than that for which it was designed. About five tons of documents were removed from the building and the Director General initiated a split schedule whereby only 50 percent of DGR personnel would be in the building at any given time. The redundant staff was utilized in a city-wide canvass of Quito to verify taxpayers' returns for the last three years of income tax, sales tax, other taxes, and taxpayers' information for the RUC and other sources. This program came to be known as the Plan Emergente. Initially, the project advisors were opposed to the idea because of the lack of planning, in particular not targeting of groups of taxpayers, and lack of control. Some of the advisors' fears were confirmed. Around 77 percent of the taxpayers cited to appear at the DGR for not being able to demonstrate compliance never showed up. Apparently there was no follow-up on these taxpayers. However, the Plan Emergente also produced some positive results. Collections attributed to the project were close to S/. 53 million. This is a small amount given the scope and duration of the program (March to June 1987) but it exceeds the amounts collected with the two previous non-filer programs. Plan Emergente also produced some useful information. Of the 14,000 taxpayers contacted, about half were not complying with some tax, a figure that confirms previous estimates. The Plan also produced 3,340 much needed updates for the RUC. Perhaps the most important contributions of the Plan was to serve as a pilot project for future efforts in this area. In fact, a much more organized Plan Emergente for Guayas started in late July 1987. This time there are manuals for procedures, forms, control sheets, etc. DGR has plans to undertake similar

programs in other provinces. Nevertheless, the Plan Emergente for Guayas remains overly ambitious. For example, the Collection Agents have close to 20 forms to potentially fill out in each outing.

The plan could also benefit from a more focused approach to taxpayers contact by making use of third-party information. Finally, it remains to be seen if this time the audit office will follow-up on the leads produced by the Collection Agents. In summary, this main activity area of the project elements is ahead of schedule. With some refinements and learning-by-doing, it promises a great deal.

### Conclusions:

Non-filing is one of the two most important methods of tax-evasion in Ecuador. Controlling this form of non-compliance, therefore, would represent a large increase in tax revenues for GOE on permanent basis. The Project so far has made a start. There is a well-defined function within DGR in charge of delinquent accounts and identification of non-filers. The Collection Agents appear to be adequately trained and the Subdirector and Chiefs of Department are well motivated. In these two initial years of the project the collection of delinquent accounts has received more attention, and logically so, than non-filing programs. The two programs so far implemented, to identify stop-filers and non-filers of Sales Tax were well thought out. Unfortunately, poor control of the information processed rendered these two programs ineffective. However, the foundations are in place for them to be repeated, this time successfully, once the data have been cleaned up.

Much more disappointing is the fact that no program has been started or even planned for withholding agents and income tax in general. The lack of processing capabilities due to delays in procurement of computer hardware is a reasonable excuse for not implementing those potential programs. It is much harder to find an excuse for not planning them.

Even though the Plan Emergente started in an accidental way, with guidance and assistance from the long-term advisor it can turn into an effective program. It is clear that DGR is convinced of its usefulness to the project. The advisors should take full advantage of DGR's interest.

Recommendations:

- a. As soon as communication between the old NCR and new Tower at DGR mini-computer at DGR is possible, the stop-filers program for Sales Tax should be reimplemented. It is very important for institutionalization that this type of program become routine before the long-term advisors leave post.
- b. At the present time there is no clearly defined responsibility within DGR to clean and update the RUC. A small office within the Subdireccion General de Procesamiento y Recaudacion should be created with the sole purpose of receiving and processing all information for the RUC.
- c. Once there is confidence that the RUC has been efficiently updated, the program to detect non-filers in Sales Taxes should be reimplemented. This program should also be part of the annual routine.
- d. DGR should not wait for the extra computer hardware to be installed to start planning a program to detect delinquent returns in Withholding. For example, third-party information from the IESS could already be collected. Ideally, special programs should also be planned to detect non-filers in income tax, long-term advisors' expertise should be used to plan special programs for professionals and craftsmen. There is evidence that in those areas the number of non-filers can be as large as the number of filers. For example, professionals that hold a private practice at the same time they are employed by a company or institution may not be declaring any income from their private practices.
- e. The Return Compliance Advisor should renew his efforts to persuade DGR to use third-party information in the Plan Emergente concentrating on the sales tax, income tax, and RUC.

### 3. Improved Audit System

#### Targets:

- (i) Audit function operating more efficiently with numbers of audits increased by 100 percent from initiation of the project.
- (ii) Unappealed assessment production per auditor per year increased from approximately S/. 2 million to S/. 4 million by the end of the project.

#### Outputs and Main Activities:

- (i) Develop programs in the first year of the project to expand audit coverage to all taxpayers. Target suspected groups of taxpayers making use of internal and external sources of information.
- (ii) Improve the technical skills of up to 100 auditors by the fourth year of the project through a series of courses and on-the-job activities.
- (iii) Improve management practices and planning and control systems in the audit function by the middle of the third year of the project. This will include the creation of a centralized review staff, the creation of a selective office audit function, and by the fourth year specialized audits of sales tax and withholding returns.
- (iv) Over the final year of the project steps will be taken to assure institutionalization of the new programs and operating procedures.

#### Inputs:

- (i) A long-term (four years) audit advisor.
- (ii) Short term advisors (6 p/m) will help design improved audit techniques and will provide on-site technical training.

Status as of July 31, 1987:

a. Targets:

As can be seen in Table 9, the number of taxpayers audited has increased from 1984 to 1986 by 74%, three-quarters of the way toward the achievement of the end-of-project goal of 100%.

b. Outputs and major Activities:

- (i) A new system for classification and selection of returns to be audited has not been introduced for lack of data. The old, flawed selection system is still in use.

Two special programs to target potential evaders using external information were initiated but have been allowed to lapse. The first program attempted to match payments reported by corporations (JDR-6) with amounts reported by taxpayers. The second program would have audited stop-filers and non-filers in Sales tax.

A third specialized-audit program using third party information on government purveyors is being considered but has not been implemented.

- (ii) To date 132 auditors have been trained in basic 8-day audit course. Also, 19 senior auditors have been trained as audit instructors and excellent training documents and materials have been developed. Thirty supervisors have received 2-day course in motivation and managerial functions.

- (iii) A new Subdireccion General de Determinacion Tributaria (Audit Office) has been established and staffed. It has two Departments — Programacion y Control, and Procedimientos y Tecnicas. This is part of the reorganization of DGR. Progress is slow in the parallel reorganization of Regional Offices.

TABLE 9

## NUMBER OF TAXPAYERS AUDITED

<u>1986</u>	<u>1984</u>	<u>Percent Change</u>
5,974	3,445	74%

(ii) Production

	<u>1986</u>	<u>1984</u>	<u>Percent Change in current S/.</u>	<u>Percent Change in real terms<sup>a/</sup> (1984)</u>
Deficiencies assessed	S/. 4.576 billion	S/. 2.356	94%	38%
Unappealed Cases	S/. 2.16	S/. 1.26	75%	19%
Average unappealed per auditor	S/. 5.3 million	S/. 3.3	60%	4%

<sup>a/</sup> discounting inflation.

Systems of managerial control and time reporting for auditors have been in the development stage since the middle of 1986 but have not been implemented yet.

Review Sections to supervise auditors' work have been planned for Quito, and later on for Guayaquil and Cuenca but they have not started operations.

The office audit function is still in the planning stage and training of auditors has not taken place. Staffing and space problems may delay its implementation.

- (iv) Input usage: Long term audit advisor Alberto Gonzalez (July 1985 - June 1986) due to illness was replaced by Arthur Trevino who started work in August 1986 and will remain in the job until August, 1988. Arthur Trevino was also a short-term advisor from April to June 1986. A second short-term advisor, Jess Hernandez worked on internal control procedures from February to May, 1986.

#### Target Achievement

Audit procedures in Ecuador have been characterized as being extremely comprehensive, slow, and legalistic. Furthermore, traditionally, audits have focused mainly on the income (personal and corporation) tax, neglecting other taxes, in particular, sales tax. Efficiency of the audit function was also decreased by a division of responsibilities between the audit department and other departments of DGR as well as slow review processes. A perhaps more important source of poor performance of the audit function in DGR, one seldom mentioned in documents, but continuously repeated in our meetings, has been the apparently widespread corruption among auditors.

This problem of corruption was not addressed in the project paper and GOE authorities have not been effective in dealing with it. Early in 1987, forty auditors suspected of unethical behavior were dismissed under the pretext of being redundant within the new DGR organization. However, practically all of them have been reinstated because of lack of documented evidence on their unethical behavior.

The objective of this project element is to increase the coverage and professional quality of the audit function within DGR. This would be accomplished by developing audit programs that target non-compliant taxpayers, by improving technical skills of the audit corps, and by reorganizing the management and internal control functions of the audit office.

Progress to date has been uneven. In order to fairly assess this progress it is necessary to keep in mind two general difficulties: the constant change of top personnel in the MOF during the period covered by this evaluation, and the strong hold of traditional approaches and procedures in the audit office. In terms of audit coverage, the program is obviously doing well. Three-quarters of the target of 100 percent increase in the number of taxpayers audited has been met in two years. Even though the number of audits in 1987 may be less than in 1986 due to the forty auditors dismissed and later reinstated, there is an excellent chance that the program will eventually meet the overall target for audit coverage.

Performance in the quality aspect of the program, as measured by unappealed audits per auditor, has been quite different. After allowing for inflation, the monetary amount of unappealed cases per auditor per year, has been basically the same in 1984 and 1986. It is practically certain that this target will not be met at the end of the project.

The inability to increase unappealed audit production is only in part a reflection of the continued inadequacies in audit selection and internal quality of audit procedures. In our opinion, the overall target in the project for quality performance is unreachable as stated. This is so for two reasons: First, better or stricter auditing will, in all likelihood, lead to more appeals, the second reason is that audited taxpayers have had a number of powerful incentives to appeal audit results. Legally, theCodigo Tributario is slanted in favor of taxpayers allowing many appeals and leaving audit results ineffective until all appeals have run their course. In practice, appeals procedures that should last up to the three months last years. In many cases, if the appeals do not get intentionally or unintentionally lost, they are eventually nullified by the statute of

limitations. Those taxpayers that finally have to pay do so in sharply devalued sucres while they have used the amount due interest-free from the government. A final reason for the frequency of appeal is that without an appeal, audited taxpayers tend to believe that they can be fined for fraud or negligence on the amount due. Under the circumstances, it is surprising that all audited taxpayers do not appeal. In fact, the relative number of appealed cases seems to have increased over the last two years.

Even though the number of appeals could be discouraged somewhat by shortening the time and increasing the control of procedures (see Processing, below), the fact remains that with the presentCodigo Tributario, taxpayers have everything in their favor to appeal.

An alternative quality target for the audit component of the project could be devised by selecting two measures: (i) deficiencies assessed per auditor per year, and (ii) relative number of audits that are sent back to auditors for review either by the newly created Chiefs of Review or by the Legal (Juridico) Department. One problem with this suggestion is that it would be difficult to establish a benchmark for (ii). At any rate, any reasonably feasible target for quality performance will be better than the present target for monitoring progress in this element of the project.

#### Outputs and Activities:

##### Better Selection of Returns

The first main activity area, the development of programs for better selection of returns in general audit and programs to target special groups of taxpayers using third-party information, has been the most disappointing. This main activity area is about a year and a half behind schedule. Within the first year of the project, as programmed, a short-term advisor, Jess Hernandez was contracted (February-May, 1986) to develop a classification and selection procedure of returns for the general audit

program. The idea was set aside apparently because returns were not available for an extended period of time for classification purposes. Mr. Hernandez went on to work on monitoring systems for audit activities. At the present time the newly reorganized audit office continues to work with the same flawed selection procedures it was using before the initiation of the project. The introduction of a new selection and classification procedures seems to be awaiting the future computerized processing of income tax returns at the Regional Office level when the decentralization program of DGR is implemented. Because planning and programming for those decentralized computerized procedures has not started (see Processing) it could take two or more years to develop the new selection procedures. This is one of the cases in which reliance on computerization may have gotten in the way of the program. Ironically, DGR has had all along the capability of obtaining up-to-date, income-tax return data. The Direccion General de Organizacion y Sistemas (DOS) has been processing all income tax returns from past years is now working on 1983, for DGR. All DGR had to do was to ask DOS to start processing 1986 returns and postpone processing of previous years.

As programmed, there was also efforts early on to implement selective audit programs based on third-party information. An information-document-matching program was designed using JDR-6 returns which in early 1986 was hoped to produce 3,700 audit leads. The program crossed information on payments by corporations with the amounts reported in the tax returns by recipients. A second program was designed to turn over to the audit office selected taxpayers from the delinquent taxpayer program for sales taxes (Transacciones Mercantiles) being implemented by the newly appointed Collection Agents (Agentes Tributarios) in the Department of Control Tributario. (See Delinquent Returns Program.)

This program which was expected to produce thousands of audit leads, was scheduled for implementation in May 1986. The immediate audit of delinquent taxpayers in sales taxes was rightly deemed crucial for the success of the new program on delinquent sales tax returns.

For a number of reasons, neither of the two specialized audit programs ever took off. The Subdirector General and Chiefs of Department for Determinacion Tributaria argued that the lack of computerized data made it practically impossible to implement the cross-information program using JDR-6 and tax return data. The audit of delinquent taxpayers in sales tax failed in part because the Delinquent Return Program had its own failings (see Delinquent Returns Program), but most importantly because of the reluctance by the Subdireccion de Determinacion Tributaria to implement it. This reluctance apparently has been based on the fear that a partial audit (of Sales Tax alone) would allow taxpayers to legally or factually evade other taxes, namely, income tax. This attitude is a good example of the ingrained old habits and subculture that the program has been fighting against. The only specialized audit program using third-party information, that is alive at the present time, is the one for government purveyors. The program will cross information on payments by government agencies and amount declared by taxpayers. However, this program has been under consideration since early 1986, and we fear it may run the same course, as the other previous two. This pessimism is based on the lack of enthusiasm for the program detected in our conversation with the long-term advisor and those responsible for its implementation.

#### Improving Technical Skills

The second main activity area of this program element improving the technical skills of the audit corps, has been much more successful. Thirty-two more auditors have been trained than the 100 initially foreseen in the project paper. Actually there are plans to train all auditors in DGR. This will be possible without any more additional resources because 19 senior auditors have been trained as instructors. The instruction materials produced so far are of high quality and auditors and instructors seem to be quite enthusiastic about the practical value of the training. This main activity area is ahead of schedule.

### Improved Planning and Control

The last main activity area of this program element improvement of planning and control systems in the audit function, presents a mixed bag of results. After some inaction and long delays, the reorganization of the DGR was approved in the Fall of 1986 (see Reorganization of DGR, below). Under the new organization all audit functions and responsibilities are contained under the same umbrella of Subdireccion General de Determinacion Tributaria. The two Departments in the Subdireccion are still experiencing space problems. Eventually as foreseen in the decentralization program, the new structure of the Subdireccion will be replicated in each of the five Regional Offices. But given the strong dependency of the decentralization program on the computerized processing at the Regional Office level, and the anticipated long delay for the implementation of regionalized processing (see Processing), it is unlikely that the new structure of the audit office will be fully operational at the required level in the next two years. There are plans to start pilot programs in Quito, Guayaquil and Cuenca Offices. In summary, the reorganization of the audit function is on schedule in the Central Office, but the same cannot be said about the Regional Offices. Possibly the Quito and perhaps the Guayaquil Offices will be partially operational within the next year. We say partially because income tax is unlikely to be decentralized by then.

### Internal Management and Control

In the area of internal management and control of the audit function, the project has developed a time control program and a quality (of audit) control program. A third type of control, honesty or ethical behavior of auditors, has not been considered.

The time-control program basically relies on a computerized time sheet for each auditor. This information would be readily available to the supervisor cadre. Negotiations about the format of the time sheet and delays in procuring and installing the necessary computer hardware has put this activity from six-to-ten months behind schedule. The basic documentation for the program has been ready since June 1986.

The quality control programs relies on the creation of Review Sections within each Department of Determinacion Tributaria. Pilot Review Sections in the Regional Offices of Quito, Guayaquil, and Cuenca have been planned for 1987. As of the end of July none of those Review Sections, were operational.

A final element of the reorganization of the audit office is the establishment of an office audit function. This is an exciting and potentially very productive move. Until now all audits were field audits. These are very time-consuming and hard to control. On many occasions similar results can be obtained with a quicker office audit. While at the present time only 6,000 field audits are undertaken each year, there is the potential for undertaking over 30,000 office audits each year with a force of only 70 auditors. Any one familiar with the state of tax returns in Ecuador can appreciate the large revenue potential of an office audit program. Documentation and procedures for the office audit program have been developed with the help of the long-term audit advisor. There are plans for the office audit function to be operational in the three major regions toward the end of 1987. However, unless some priority is given to this program, space and staffing limitation are likely to put it behind schedule.

Conclusions:

The initial importance of the audit function in any tax enforcement program cannot be over-emphasized, especially in countries like Ecuador where there are very low rates of voluntary tax compliance. The best organization structure, return processing systems, and delinquent taxpayers programs can be rendered ineffective if the crucial link of the audit function fails. All this is well recognized in the project paper. Progress to date has been uneven. As could be expected, progress has been faster in the training and organizational areas and much slower in the operational area. But it is on this latter where ultimate success lies. The audit functions of DGR will be successful only by generating extra revenues in the general and specialized field audit programs and the office audit programs.

Recommendations:

- a. The DGR and the Audit Advisor should modify the overall quality target of this program element. The present target, measured in terms of unappealed assessment per auditor per year, will not be an effective instrument for monitoring future progress.
- b. To be able to develop new selection and classification procedures for the general audit programs, as well as for many other reasons, DGR should ask DOS to stop processing income tax returns of past years and start processing returns for 1986.
- c. The Audit Advisor and the OMNIMAX Chief of Party should take the lead in reintroducing and implementing the specialized audit programs using third-party information.
- d. Even though the training component of two elements of the project has been quite successful, continued educational efforts will be needed beyond the departure date of the present long-term audit advisor.
- e. The project team and DGR should consider decentralizing the audit function without waiting for the full computerized processing system to be in operation.
- f. To complement the scheduled time and quality control programs for auditors, DGR should consider introducing an ethical behavior or honesty control program. This could be done within the newly created internal Professional Inspection Program (see Professional Inspection Program below). A well-documented investigation of several unethical auditors, followed up by criminal suits under the Penal Code would probably go far to bring in more ethical behavior among auditors. This problem should not continue to be ignored. DGR will never be able to deal effectively with taxpayer dishonesty unless it deals with dishonesty within its ranks.
- g. The MOF should give space and staffing priority to the office audit program.

B. ORGANIZATIONAL IMPROVEMENTS

1. Reorganization of DGR

Target:

Reorganization plan approved by MOF in year 1. Phased implementation in years 1, 2, 3. New organizational structure in place throughout country in year 3.

Major Outputs and Activities:

- (i) Sixty executives and managers trained in-country by yr. 2.
- (ii) 110 managers given advanced U.S. training by yr. 4.

Inputs:

Technical Assistance, Chief Advisor, other long-term advisors, short-term assistance (3 p/m). Training in U.S., in-country and third country. Vehicles and office equipment.

Status As of July 31, 1987:

a. Target:

There was a delay in the approval of the reorganization plan. It was not approved until the beginning of year 2 by MOF Acuerdo No. 664 of September 26, 1986, published in the Registro Oficial October 9, 1986. Phase one, the Reorganization of Central Office of DGR is complete.

b. Outputs and Major Activities:

In regard to training, 52 executives and managers have been enrolled in the seminars on management carried out in Quito.

With regard to advanced training, 52 DGR's officials attended the management course in the U.S.

Target Achievement:

The implementation of the reorganization plan got off to a slower start than planned in the PP because of hesitation and reservations by the Minister of Finance. Because the initiation of the reorganization of the DGR was a condition precedent to disbursement of funds under the project in year 2, this delay caused the USAID to notify the MOF in writing in March 1986 of a suspension of disbursements until the reorganization was begun. Although the DGR made preliminary moves to reorganize, the official document authorizing reorganization was not signed until September 26, 1986 and was not published in the Official Register until October 9, 1986. This delay has put the entire project behind schedule by from six to nine months. It, also has complicated the procurement time table and forced a doubling-up of a number of purchase orders (see Procurement, below).

Once the reorganization plan was official, the DGR took immediate steps to implement it and most of the reorganization of the DGR Central Office, phase one, was complete by April 1987.

The implementation process is divided into five different phases. The first phase covers the following activities: The appointment of the four DGR Subdirectors; the selection of the technical personnel and Department Chiefs for the new subdirections of Processing and Collection, Tax Control, and Tax Determination; the development of a study on office reorganization, and needs for additional physical space; the training of executives of DGR and each regional office in the U.S. for four weeks; the joining of the Department of Tax Collection and Coordination of Collections to the Subdirection of Tax Control; the reassigning of the functions of Planning and Dissemination of Technical Publications into a new department; and the absorption of the Administration Department by the Subdirection of General Administration.

The functions of the three departments, delinquency, audit and processing, mentioned in the PP have been clearly defined, and each is operating under its own sub-director (see Organizational Chart). It should be noted that in regard to the "development of a study on office reorganization and needs for

additional physical space," three studies were developed and submitted to the DGR Director, for his consideration and approval. These studies are: a) A manual for the administration of DGR's File and Document Center ("Manual Interno para el Uso, Manejo, y Custodia de la Documentacion del Archivo General de Rentas," 30 October, 1986); b) A manual for processing and filing of documents of DGR's Secretary ("Manual Interno para la Administracion de Documentos y Archivo de la Secretaria de Documentos y Archivo de la Secretaria General de Rentas" 22 December, 1986); c) Instructions for the administration, control and reproduction of documents - Microfilm ("Instructivo para la Administracion y Control de la Reproducion de Documentos," 20 April 1987).

The second phase of the reorganization includes the following steps: The implementation of the organizational structure in the regional offices; the appointment of Regional Directors and department's chiefs; the initiation of activities in the regional offices; the assigning of the part of the Tax Audit Department to the Northern Regional Office; the holding of a seminar on management for technical personnel in Quito and chiefs of regional offices (e.g., delegados); a four week training course for the participants of the management seminar.

Most of the above activities were completed between February and July 1987, with the following exceptions: The decentralized audit system in the Regional offices has not been completed (see Improved Audit Systems, above). The implementation of the Department of Processing and Collections, within the new organizational structure, for the five regional offices, has not begun yet. This is due to the fact that their operation depends on the installation of mini-computers whose procurement is still under way. Therefore, the intitiation of activities in the regional offices has been only partially implemented. (See Restructured Processing System, below.)

With regard to training of personnel, 87 percent of the executives have been trained; and 47 percent of the managers have already received advanced training in the U.S.

However, there are still some serious weaknesses at some management levels within the DGR. In spite of the training, there is a need for a more general application of improved management techniques in many of the DGR offices. This can be attributed to some extent to the continuing turnover of supervisory personnel; but, it is not limited to this. It is important that the Director General not only try to retain his most capable managers but should put additional emphasis on tighter management in all the DGR offices.

The problem of turnover of supervisory personnel is related in many cases to a disregard for established Ecuadorian Civil Service rules and regulations on promoting and hiring of professional civil servants. A stricter application of these regulations would improve the long-term prospects for the success of the reorganization of the DGR.

The third phase deals with the planning of the decentralization of the processing system. The planning activities are: (1) design of the system, describing requirements of processing, and defining characteristics of the equipment; (2) procurement of the computational equipment; (3) carrying out of specialized seminars for personnel of the General Subdirection of Processing and Collections and personnel of the Processing and for Collection Department of the Regional Offices; (4) development of a study for gradual decentralization of processing of tax returns and tax computation and issuance of tax bills (e.g., "Títulos de Credito Tributario").

The above activities were to be developed between January and September 1987. However, only the first task (computer procurement plan) has been developed. This project element is behind schedule about 9 months. In regard to the study for gradual decentralization of tax returns, this has been accomplished for the sales tax only. No progress has been made in this regard with respect to the income tax. (See Improved Return Filing Compliance, above.) This is due to the lack of computer programmers, and difficulties in hiring new personnel. The specialized seminars have not taken place. As noted above, the departments for processing and collection, at the regional level, have not yet been organized. Therefore, there is no staff ready for training in the processing and collection system at the regional level. (See Restructured Processing System, below.)

The fourth and fifth phases refer mainly to the documentation of both processing systems and claims and complaints functions, respectively. These activities were supposed to take place during the last quarter of this year, with the initiation of decentralization of the processing system. However since the completed studies for a gradual decentralization are not ready, the staff is not yet appointed and the equipment not in place, it is not expected that this phase will be completed for at least another year.

Conclusions:

Because of the initial delay in implementing the reorganization plan the entire project is behind schedule by from six to nine months. Phase one, the reorganization of the Central Office is complete. Phase two, the reorganization of the Regional Offices is underway, but is being delayed because the procurement of computers is behind schedule. The final phase of processing returns in all regional and area offices is not likely to be in place until a year or two after the project completion date.

The new organizational structure, in contrast to the old structure, is much more functional; the distribution of responsibilities is more comprehensive and related to particular functions. It makes much more sense in terms of basic requirements in the administration of the tax system.

Motivation and support for the reorganization is high among DGR personnel both in the Central Office and at the regional level. This, of course, is essential to the success of the effort. The Project Coordinator is especially vigorous in pursuing the reorganization goals and has done a good job of motivating DGR staff. Nevertheless, it is important that the DGR retain its most capable managers and that supervisors introduce and practice improved management techniques.

The decentralization process, embodied in the reorganization, is especially dependent upon a high level of output and leadership from the Department of Systems and Tax Procedures (Dept. de Sistemas y Procedimientos Tributarios). It is, therefore, important that this unit be headed and staffed by experienced and well-qualified individuals.

Nine people were trained to carry out the activities in this Department. However, only three were hired on a permanent basis. There has been a need for additional staff since September, 1986. As it stands, this constitutes a serious problem for the development of computer programs. (See Restructured Processing system.)

With regard to training of DGR officials and management personnel of Regional offices, in the U.S. and third countries, a number of top managers resigned after receiving training. It is important that managers to be trained be chosen on the basis of their professional competence and the expectations that they will continue to work for the DGR. Institutionalization of the system is dependent on keeping personnel once they have been trained.

Physical space in the DGR is at a premium and is already a serious constraint in achieving project objectives, e.g., there is no space to accommodate a new terminal in DGR's Computer Center. The reorganization of the Northern Regional Office is also affected due to the lack of office space. A study on physical space was carried out last year, and the need to acquire a new building was identified. However, to date, no action has been taken. Additional space is absolutely essential to the project's success.

Recommendations:

- a. The staff of programmers in the Systems and Tax Procedures Department ("Departamento de Sistemas y Procedimientos Tributarios") is not sufficient to carry out its tasks. As an immediate action, the staff should be increased to at least ten.
- b. The Director General should emphasize the importance of improved management techniques to the success of the reorganization and should insist on a strict application of Civil Service rules and regulations in the promotion and hiring of DGR supervisory staff.

- c. Before providing training in the U.S. or third countries, the DGR should get a firm commitment from those participating that they will continue to work for the DGR for at least one year after their return. This is especially important for management personnel.
  
- d. The lack of availability of office space is slowing the reorganization and decentralization process. Steps for the acquisition of a new building in Quito should be speeded up.

## 2. Restructured Processing System

### Target:

A manual and automated processing system is functioning which integrates processing of individual accounts with a master file without backlogs and which provides operating data on a timely basis.

### Output and Major Activities:

- (i) During first two years introduce improvements in the processing area that will have an immediate impact on improved revenue generation: i.e., bringing up to date processing of Sales Taxes, and establishing processing control over monthly employer withholding tax returns.
- (ii) Restructured and automated returns processing system decentralized to the regional offices in place by year 3. Full communication between regional and central offices with updated master central files in place by year 4.
- (iii) Improved management and technical capabilities. Up to 30 processing technicians trained by year 3. Six systems analysts trained in the U.S. by year 4.

### Inputs:

- (i) A long-term (four years) Systems Advisor.
- (ii) Short-term specialists in computer systems (3 p/m) and short-term specialists in computer operations (3 p/m).
- (iii) Loan funds will finance the purchase of minicomputer systems.

Status as of July 31, 1987:

a. Target:

New NCR Tower minicomputer installed at DGR to process Sales Tax Programming of "Area Office Cashier System" and "Secretarial Control System" is at an advanced stage. Some planning has been done to control Portofolio of Titulos de Credito. Planning and programming in other areas (income tax, withholding, and other taxes) is not even at the planning stage. Programming to update RUC has been slow and it is unclear what effective progress has been made in this area during the last two years.

Overall systems design for decentralization of processing to area offices and the five regional offices has been completed and pilot plan for Pichincha province will be in place by the beginning of 1988. This element is one-to-two years behind schedule. The overall target will not be achieved without a project extension of one or two years.

b. Major Outputs and Activities:

(i) Early in the project it was decided to reinstitute the NCR 9100 minicomputer installed during the pilot project to process Sales Tax for a more versatile NCR Tower minicomputer. Data converting from the old to the new minicomputer has been slow and painful. Conversion is almost completed. Sales Tax data were used in two programs to detect stop-filers and non-filers. Processing of monthly employers withholding tax returns was never implemented and it is not even at the planning stage.

(ii) Restructured and automated returns processing system will not be decentralized to all regional offices (and area offices) by end of year 3. Partial processing may be decentralized in Pichincha and perhaps Guayas by end of year 3. Computer hardware may be installed by end of project in all regional and area offices, but

the decentralized system will not be operating by then. There have been significant delays in procurement of the computer hardware. (See Procurement, below).

(iii) Nine programmers have been trained in UNIX operating system and "C" programming language, but only three have been hired by DGR. Programming staff is the most serious bottleneck of this project element. (See Reorganization of DGR, above.) There have also been staffing problems with key punchers. Some of the top managers trained in the U.S. have resigned. There are problems with technical support for programmers.

c. Input Usage:

Long-term processing advisor James Westrick arrived post in October 1985. He is planning to stay until end of the project in 1989. No short-term advisors have been hired. Micro-computers and software started to arrive at DGR in July 1987.

Target Achievement:

Tax returns data processing in Ecuador has been slow and cumbersome, overly centralized and almost entirely unresponsive to enforcement needs. In spite of the existence of a mainframe computer and a systems and programming team within the Ministry of Finance at DOS, tax return processing DGR has remained largely manual. DOS has been serving many masters, customs, budget, national debt, etc., and as a consequence it has provided DGR with poor services. Processing of income tax returns at DOS is four years behind. Before the purchase of the minicomputer for DGR, processing of Sales Taxes was two years behind. The maintenance of the RUC at DOS has also been poor. The only timely work by DOS for tax enforcement purposes has been the printing of Titulos de Credito.

The processing element of this project was conceived as an ambitious plan to (i) computerize all aspects of tax return processing and management, and (ii) decentralize many of DGR activities to the regional offices and area offices. The Central office at DGR would perform programming, management and archive functions. DOS would only maintain and update the RUC.

To put in perspective our discussion of progress to date, it would be convenient to review the dimensions of this project element. First, up to fifty tax and collection instruments, including income and sales tax, have to be programmed. Cashier, appeals, and all other secretarial functions would also have to be programmed. Specifications and communications systems for 40 computer systems would have to be designed. These computers would have to be procured, delivered and installed, this latter many times in quite remote areas where space, electric and other facilities may be lacking. Computer and systems analysts would have to be trained in a new, to them, computer language and operating system to be able to staff the central, regional, and area offices. Other DGR personnel would have to be trained in word processing.

Three general considerations follow from the description of the scope of work for this project element: (1) The project may have underestimated the level of inputs and time needed to complete the task. (2) This project element may have gone too far in trying to computerize all at once every element of the DGR operations. Viewed in one way, computerization has delayed or gotten in the way or slowed down the main purpose of the project: to implement enforcement programs that raise revenues for DGR. Tax enforcement systems have worked well in many countries before the computer age. The complete reliance of the operational and decentralization aspects of the project on computerization is worrisome when DGR copying machines go for six months without being fixed for lack of funds or when DGR has no funds even for bus fares for collection agents. Will there be funds for staffing, maintenance, replacement for the computers? If the answer is, unlikely, then what will become of the project in the long run? (3) This is an appropriate time in the life of the project to reassess how much can be done with budgeted funds. If an extension of the project is unlikely or not desired, should there be a retrenchment in present plans to establish priorities in terms of revenue raising potential?

#### Output and Major Activities:

This project element is behind schedule because of programming and procurement difficulties. The best example of programming difficulties is illustrated by the conversion of Sales Tax files in the old NCR 9100 minicomputer to the new NCT Tower minicomputer. As a product of the pilot project, in 1985 Sales Tax returns were already being processed at the NCR 9100 minicomputer at DGR. Only

these returns for Pichincha were processed at DOS. After the arrival of the long-term Processing Advisor it was decided to switch to the newer and more versatile Tower minicomputer. This required a conversion of returns files from the old to the new computer. The monthly reports from the project contractor are replete with deadlines to implement this file conversion. But all kinds of difficulties were encountered. As of July 31, 1987, even though all programming has been finalized, full communication between the old and new minicomputers has not been implemented because of lack of a piece of hardware. To switch minicomputers at DGR was probably a good idea, but it took an inordinate amount of time and effort of the long-term advisor and the programming team to accomplish it. After all, a computerized, although quite rigid, processing system for Sales taxes was already in place at the beginning of the project.

Programming in other areas has been slow and priorities have not always been well established. Planning and programming for income and withholding accounts have not started. Instead scarce resources have been used to program "Secretarial Control System." This program which introduces word processing in appeal processes and other sectional functions is a worthwhile program. But it is hard to find a justification, other than DGR own preferences, for why it should have taken priority over the programming of income tax and withholding accounts. In this case, organizational issues in the project again took precedence over operational and tax enforcement objectives. At any rate, the "Secretarial Control System" seems to be near implementation stage.

Another program awaiting a pilot trail of the Pichincha province is the "Area Office Cashier System." The study was completed in September 1986 and delays in computer procurement have postponed its implementation. The "Area Office Cashier System" will have important advantages: It will implement a cash control of all receipts, it will control the portfolio of Titulo de Crédito, it will process the basic fields of all declarations at their input stage, and it will allow a cross check of all taxpayers liabilities across the nation. The "Area Office Cashier System" is a good example of how advanced the decentralization plan really is. Unfortunately, its implementation will have to contend with the kinds of problems and delays discussed above.

Shortage of qualified personnel has been one of the most important reasons that programming is behind schedule. A total of nine programmers have been trained so far in UNIX operating system, "C" programming language, and UNIFY file systems. Of these nine programmers only 3 have been hired by DGR. Plans to hire 3 or 4 more of the trained programmers have not materialized. Systems and programming language are new to the three DGR programmers, and with the exception of the long-term advisor (who is doing many other things), there is no technical support to answer questions, solve systems errors, etc.

The programming area presents both short-run and long-run problems. In the short-run, the lack of programmers constitutes the most important bottleneck in the implementation of the decentralization plan. It is anticipated that a short-term programming advisor will be in-country in the next few months. But given the dimensions of the tasks to accomplish and how far behind schedule this project element is, more emergency action is needed. One or two more short-term advisors could be brought in to help program and document all other areas of processing. A probably cheaper and faster substitute would be for local programmers to be hired with project funds to program and document modules in particular areas on a job-done job-paid basis. In Quito there seem to be university and private business programmers knowledgeable in UNIX and "C" language.

In the long-run up to 20 programmers and system analysts will be needed to staff the computer systems in the regional and area offices. A large number of processing personnel will also have to be trained. Now that the computer equipment has started to arrive at DGR, it may be the time to start recruiting and training these personnel. If at all possible these personnel should be from the regions and cities where they eventually will be working. We foresee difficulties in being able to keep relatively sophisticated civil servants, like programmers, in small towns or cities where many of the area offices are located. To judge from the difficulties experienced at present to hire more than 3 programmers at DGR, there will also be problems getting all 20 programmers and system analysts in the budget.

An example of procurement difficulties which have caused project delays is the order for micro-computers for the DGR which was placed in April 1986. The first pieces of hardware did not arrive at DGR until July 1987. The delay was first caused by the suspension of funds when MOF delayed its approval of the proposed reorganization of DGR. After the reorganization plan was published in the Official Register in October 1986, further delays were caused by AID procurement procedures, delays with suppliers, and customs red-tape. (See Procurement below.) The long procurement cycle has led the project to order most equipment at once without proper testing of components. Thus, a good number of printers that have arrived are not well suited for the Cashier program and the project is now trying to swap them. Once all computer hardware and software needed for the decentralization arrives, it will take optimistically a year and more realistically the rest of the project duration to initiate it in the regional and area offices. The lack of space and electric facilities, already experienced in Quito, could make final installation an even longer run proposition. Lack of competent personnel has delayed now for six months the installation of an air conditioning unit in the computer center of DGR. Procurement, logistics and day-to-day details of the installation should not take such an important part of the long-term processing advisors's time as has been the case to date. It would make much more sense to hire someone locally to take care of these details.

Conclusions:

This project element represents the undertaking of a very ambitious computerization and decentralization plan for tax returns processing. If it is accomplished as planned, it will give Ecuador one of the most advanced systems in tax return processing. At this time, the project element is at least one year behind schedule and there is little hope that it will be completely in place by the end of the project. The Project Paper underestimated the time and resources needed to complete the task. Understaffing in programming and procurement delays have had a serious impact on the time schedule for implementation.

Recommendations:

a. Because there is little hope that this project element will be finished during the life of the project, and because of the considerable resources involved, this is the time for AID to consider the possibility of extending the project. If the answer to an extension is no, then AID, the Contractor, and DGR should immediately enter in negotiations to retrench in this program element and redirect committed resources to other elements of the project. The danger is that by the end of the project there will be a number of computer systems in place in regional and area offices mostly to process what is now being done quite well at the Central DGR Offices: e.g., sales taxes.

If AID decides on extending the project, the following recommendations should be taken into account:

- b. The computerization and decentralization plan may be too sophisticated for the level of development of Ecuador and the economic resources available to DGR. Therefore, worst-scenario planning is needed to have back-up systems in case computer equipment at an increasing number of offices cannot be maintained or replaced. It is not enough to have two or three spare computer units. These, in time, will be used up. By then the whole project effort may revert to the situation in DGR before the project started. Manual back-up systems and emergency procedures should be an integral part of the decentralization program. They are likely to be needed.
- c. Programming priorities have not been followed. In particular, as in other aspects of the project, nothing seems to have been done about income tax and withholding returns. Planning and then programming for processing of income tax returns should be started at once (see next recommendation).
- d. The serious bottleneck in programming should be overcome. It is not realistic to try to implement this ambitious project element with inexperienced programmers. Short-term advisors (more than one) should

be brought in as soon as possible. It would be a good idea to use loan funds to contract with local programmers on a piece-meal basis.

- e. The recruitment and training of programmers and system analysts of Regional and Areas offices should not be delayed. Past experience tells us that this will be a long road. USAID and the Contractor should emphasize, once again, to MOF the importance of including some slots in the next budget for these programmers and as well as other processing personnel needed in the decentralization plan.

3. Professional Inspection Service

Target:

Unit established in year 2, with staff of approximately 20 in place; will be fully operational by end of year 2.

Inputs:

Chief Advisor will oversee activity. Short-term specialist to help in design and initial implementation.

Status - As of July 30, 1987:

A Department of Administrative Control has been established in the DGR with a 12-member staff. Internal operational plans are being developed.

Target Achievement:

As stated in the project paper, the objective of this project element is to create a separate, independent unit, outside the chain of command, to assure the Director General of the integrity of his operation. Its major functions, internal audit, internal security and investigations, were being carried out, if at all before the reorganization of the DGR, in an uncoordinated fashion in the Department of Operational Auditing and Tax Investigation and in the Office of the Coordinator of Delegations.

The original project implementation plan called for a short-term specialist working under the Chief Advisor to arrive in January or February of 1986 to help design the new unit and to initiate its functions. However, the contractor had difficulty in securing a short-term specialist within that time-frame.

This coincided with a slowdown by the Ministry of Finance in implementing the overall reorganization of the DGR (see Reorganization above). Since reorganization was a major project objective, the delay created uncertainty with regard to establishing a new inspection unit without full assurances that the reorganization would take place. Under the circumstances, the initiation of the inspection unit was postponed.

Once the reorganization was underway, a new unit, called Department of Administrative Control, was established in the DGR, a Chief of the unit named and 11 staff members assigned in March 1987.

The New Department of Administrative Control was designed to include all the functions of the Professional Inspection Services described in the Project Paper. Also, plans were put in motion to bring in a short-term specialist to help design and initiate the activities of the new unit. However, once again, difficulties were encountered in securing the services of a specialist. In the absence of this short-term technical assistance, the Chief Advisor, and the Ecuadorian Project Coordinator initiated a number of measures to make the Administrative Control unit a working reality.

The staff members of the unit chosen from other offices of the DGR were personally selected by the new Department Chief on the basis of education, experience and personal characteristics suitable for their positions. Internal orientation programs and seminars were organized and arrangements made to have the staff attend regular audit courses and inspection training courses conducted by the office of the Controller General of Ecuador. The only area not covered in the Controller General courses is internal security. Alternative training arrangements must still be made to cover this material. Five staff members have already finished three separate courses run by the Controller General's Office. The remaining six will be enrolled in similar courses in September.

Although the new Department has already initiated a limited number of investigation, it is still not functioning at optimum capacity. The staff members, although nominally assigned to the new unit, have not yet been

formally transferred and some are still carrying out functions of their former positions and are still being paid by their former offices. It is anticipated that this will be corrected by December and that the new Department will have in its 1988 budget sufficient funds for its 12-member staff.

An operations manual is being prepared and work plans are being drawn up. The Chief of the new Department expects it to be fully operational by January 1988 if he can arrange for additional office space with the Ministry.

Conclusions:

This project element is approximately six-to-nine months behind schedule, the two major causes of delay were the lack of short-term technical assistance and the slow down in the reorganizations of the DGR. The reorganization is now proceeding apace, but the lack of technical assistance continues to be a problem. The Contractor, after having made persistent and repeated efforts to secure short-term consultants, has concluded that it is extremely difficult to locate a qualified Spanish-speaking Consultant and is now considering various alternatives to prepare the Department of Administrative Control to carry out all its functions. Among the alternatives are on-the-job training in similar units in other countries for individual staff members. It is doubtful, however, that the new unit will be able to fulfill the expectations of the project agreement during the life of the project without additional technical input. It should be noted also that another constraint to satisfactory implementation of all aspects of this project element as described in the project paper relate to the serious space problem of the DGR.

While the new Department of Administrative Control conforms in most aspects to the project paper's description of a Professional Inspection Service, it is less ambitious in the sense that it has been initiated with 12 staff members rather than the 20 suggested in the project paper. This is not a serious shortcoming, however, since the original proposal was itself an

estimate. Only experience can determine optimum staff size. Emphasis should be placed, rather, on the unit's effectiveness than on the size of its staff.

Recommendations:

- a. The Contractor should continue its efforts to provide short-term technical assistance to the Department of Administrative control as well as pursue alternative approaches.
  
- b. The MOF should take early steps to relieve the DGR space problems in general and provide additional space for the newly organized Administrative Control Staff.

4. Public Relations

Target:

By end of year 2, a public relations firm will have prepared a marketing strategy and a public relations office will have been established and operating.

Inputs:

Technical Assistance by public relations firm.

Status as of July 31, 1987:

Under the reorganization of the DGR a Department of Information and Technical Publications was established and is functioning. One illustrated pamphlet has been prepared and distributed as well as a number of technical publications.

Target Achievement:

The PP put special emphasis on the potential role that a public relations program could play in changing taxpayer attitudes and behavior toward tax programs. It pointed out the necessity of changing the location of the PR functions at Ministry, placing it within the DGR, developing messages targeted at specific groups and providing more consistent dissemination throughout the year of tax information and taxpayers' reminders. The PP also mentioned that the proposed reorganization of the DGR contemplated the establishment of a Department of Information and Technical Publications.

Even before the publication in the Official Register of reorganization of the DGR in October 1986, the DGR had taken steps to set up its new Department of Information and Public Information. It consisted of a Chief of Department, a Programming and Information Section, a Technical Publications Section and a Technical Library. Each section was assigned four professionals and one in the library. The Department was also

assigned an administrative assistance and a mimeograph operator. Position descriptions were prepared for each function and classification of the positions obtained. The 1987 Operative Plan for the DGR described the activities which the department would undertake for the year which included (1) forming working groups to provide counseling to field officers on the proper handling of income tax returns and to taxpayers on their obligations under the law; (2) design and carry out a public information program in cooperation with the Public Relations Department of the MOF; (3) produce and publish forms and technical guides to help the taxpayer complete tax declarations. It was also charged with redesigning and tax forms. During the year the Ministry has published a number of Guides for the tax year 1987 as well as a pamphlet explaining the income tax and the various forms used. Some of these were produced by the MOF Public Relations Office and others by the Department of Information of the DGR.

Conclusions:

Even though the DGR Department of Information is a functioning entity, it has not yet focused on the objectives described in the PP which emphasize a public relations program capable of changing taxpayer attitudes toward tax programs. No action has been taken to contract a local public relations firm to develop a marketing strategy for the Department, nor has the Department itself designed such a marketing strategy. The present members of the Department staff have been transferred from other functions within the DGR, and although they all have experience in DGR operations and some have audit experience, none have public information experience. All of the activities now being carried out by the Department are those which were previously performed by various DGR offices before the reorganization. Thus, while the reorganization has succeeded in bringing these activities together in a rational manner, it has not yet constructed an entity which can provide leadership in developing a public information program for the general public.

Recommendations:

- a. Now that the New Department of Information and Technical Publication is a reality, the DGR should strengthen it so that it can undertake the expanded functions spelled out in the PP and the Project Agreement. The Department staff needs both outside technical assistance and training to fulfill its functions. If it is now deemed impractical to contract a local public relations firm to design a marketing strategy, the contractor should bring in short-term consultants to help design the strategy and to help train the staff.

## 5. Procurement

While this section of the evaluation does not fit strictly within the structure of the logical framework, it is meant to be an addendum to and comment on the foregoing Organizational Improvements section of the report.

For better or worse, this project was designed around the computerization of the Ecuadorian Tax System. Both the reorganization of the DGR and a restructured processing system are intimately related to and dependent upon the procurement, delivery and installation of computers. The budget for the reorganization of the DGR includes \$820,000 for equipment and the budget for a restructured processing system includes \$1,050,000 for equipment. This accounts for the entire \$1,870,000 included in loan 518-V-061 for equipment. Therefore, the successful implementation of this project is heavily dependent upon the timely procurement of the equipment budgeted and planned for.

It was brought to the attention of the evaluators that there have been serious procurement problems during the first two years of the project. Because of the central role equipment plays in this project, it was decided that the procurement problem should be examined in some detail, especially since less than one-fourth of the total procurement under the project has taken place.

The original procurement schedule set up in the PP anticipated that all equipment would be procured in phases starting in year 1 and being completed in year 3. It was originally expected that the vehicles would be ordered in four phases under mission procurement (each action under \$100,000) beginning in year 1 and being completed in year 2. The computer systems were to be ordered starting in the last quarter of year 2 and completed in the second quarter of year 3. Office equipment was to be ordered starting in year one and completed in the first quarter of year 2.

On the basis of an examination of the PIO/C's on file, it appears that orders for Computers and office equipment worth \$360,440 have been placed and vehicle order of \$454,000 is being advertised.

From the beginning, procurement of equipment under the project has been a source of delay to project implementation. The original project documents did not anticipate the problem. In fact, it was assumed that potential procurement problems could be avoided by shifting responsibility from the MOF to the USAID. The PP stated the following: "Under the pilot project, the DGR has consistently requested that USAID directly procure all services and most commodities. This practice will be continued under the follow-on project." Further on it states: "The area of greatest weakness — procurement — will be largely avoided by shifting the responsibility to AID."

However, the PP did not shift total responsibility to AID. The Commodity Procurement Plan (Annex III-G) states: "All commodities will come consigned to the MOF which will be responsible for customs clearance and delivery."

However, far from avoiding procurement problems, the project has suffered a series of delays which have had a negative effect and contributed to a slow-down in project implementation.

The Contractor has no obligation under the contract for procurement, per se. The PP assigns USAID this responsibility. Within USAID, the Project Officer has primary responsibility. A number of factors, including the Project Officer's heavy workload and loss of local staff, combined with changing AID/W and USAID procurement policies and practices have been responsible for many, if not most, of the equipment procurement problems.

Because project implementation is so closely related to the timely procurement and installation of computer equipment, the contractor, from the beginning, went beyond the strict limits of its obligations under the contract to work closely with the USAID to identify procurement needs, prepare specs and initiate procurement documents. In fact, the Systems and Computer Specialist has dedicated a large part of his time to this activity. Nevertheless, he is not a Procurement Specialist and had to learn as he went along. The Project Officer had no one on his staff familiar with AID procurement requirements, so had to depend on guidance of

the staff of the Executive Office, the Development Resource Office and the Controller's Office, since the Mission does not have a full-time Procurement Officer. This resulted in some procurement documents having to be prepared a number of times before they could be formally submitted which sometimes caused substantial delay. Adding to these delays all procurement requests of over \$100,000 had to be submitted to AID/W through the Regional Contract Officer in Lima, which lengthened lead time by approximately a month for procurement actions. An illustration of procurement problems caused by these factors are PIO/C's 518-0042-50179 for \$114,000 of March 27, 1987, and PIO/C 518-0042-50184 for \$454,000 of May 11, 1987.

Procurement action under PIO/C 50179 for computer equipment was begun in February against a March 31 deadline related to the time at which the GSA contract, under which the equipment was being purchased, terminated. The initial equipment identification and specification preparation were completed by the Contractor and forwarded to the Project Officer. A PIO/C was prepared and routed for clearances, but was held up due to the absence of one officer on the clearance list. Observations on the PIO/C from that office on the return of that individual necessitated a redrafting of the PIO/C. Then, on a rush basis, it was again rerouted for clearance on March 27. It was cleared by the Executive Office on March 30, by DR Office March 31, the Controller on April 2 and signed by the AID Director on April 4. Even though the contractor had taken the extra precaution to get assurance from the suppliers that the purchase order would be honored in spite of the March 31 deadlines, the Executive Officer refused to transmit the PIO/C and purchase order to AID/W because the GSA deadline had been passed. This required the entire procurement action to be started again with the identification of suppliers and the rewriting of specs. Estimated delay, at least 30 days.

Procurement action under PIO/C 50184 was begun in April 1987. The PIO/C started through USAID clearance process on May 11, 1987 and was signed off by the Mission Director on May 27, 1987. It provided \$454,000 for 29 vehicles for the DGR, to implement the reorganization plan, to extend its reach into rural areas and to increase the mobility of DGR agents. As required, it was forwarded to the regional contract officer in Lima who was nearing the end of his tour there. At the beginning of August, the USAID

was informed that no action had been taken by the departing Contract Officer and that action would have to be initiated by the new Regional Contract Officer recently assigned to Quito. Estimated delay, at least 60 days.

Unfortunately these are not the only procurement delays suffered by the project. There are also serious problems related to getting project supplies and equipment out of Ecuadorean Customs. These delays are not peculiar to this project, but as expected, have a negative impact on it. These problems are long-standing and are related to the idiosyncracies of Ecuadorean government bureaucracy. As mentioned above, the PP recognized this problem when it indicated that procurement would be shifted to AID. It was hoped that AID would be able to by-pass Ecuadorean Government requirements that had caused endless delays on previous projects through slow retrieval of equipment and supplies from customs. Nevertheless, because of internal differences in USAID, the PP was ambiguous if not contradictory on this point. The PP Commodity Procurement Plan (Annex II G) states that: "All commodities will come consigned to the MOF which will be responsible for all customs clearance and delivery..." in effect subjecting project-imported equipment to the very problems which the PP Administrative Analysis section indicated would be avoided.

Indeed, early procurement actions under the project confirmed that commodities consigned to MOF were likely to remain in customs indefinitely. Therefore, the USAID Director revised Mission practice and directed that project commodities be consigned to USAID. Even with this change, however, it takes from four to six weeks for commodities to clear customs.

In August 1987, after the USAID consignment system had been functioning for about a year, the Ministry of Foreign Affairs questioned the practice of consigning project equipment to the USAID rather than to the Ministries and announced that it would provide liberation only for that equipment which the Mission declared was property of the U.S. Government. This has given rise to suggestions in the USAID to once again consign project commodities to the Ministries. If this action is instituted, the entire project will

be in serious trouble since the \$454,000 order for vehicles is being advertised and the projects' largest single procurement action for \$785,000 is about to be initiated.

There was one other major procurement delay unrelated to the above problems, which has been resolved but which must be mentioned to make the record complete.

One of the conditions precedent to disbursement of funds in year 2 of the project related to the MOF instituting a reorganization of the DGR. After six-to-eight months of delay in starting this reorganization, USAID notified MOF in writing on March 28, 1986, that disbursements would be frozen until the MOF complied with the reorganization requirement. Not only did the freeze apply to procurement actions in progress but to commodities already ordered. This suspension of disbursement remained in effect until October 9, 1986, when the MOF published the new DGR reorganization plan in the Ecuadorean Government Official Register. As a result there was a back-up in procurement actions which had been programmed for earlier execution. This required revising the original procurement schedule and doubling up purchases, rather than stretching them out in the orderly fashion originally contemplated in the PP. (See Restructured Processing System, above.)

Conclusions:

Commodity procurement under this project is a serious problem which needs immediate and continuous attention by the Mission Director and his staff. While it has not yet been responsible for a bringing the project to a halt, it has contributed to the project being behind schedule. It is ironic that the very action that the PP anticipated would avoid procurement delays, i.e., shifting procurement responsibility to AID, has actually contributed to such delays. This is likely to continue until the USAID focuses on the problem and organizes itself to overcome it.

The Project Officer has recently added a new staff member to assume responsibility for this project and to concern himself with procurement problems. Unfortunately, he has no previous experience with AID, nor with procurement. Nevertheless, he will be able to shepherd the upcoming procurement documents through USAID and keep the project officer advised on procurement problems and delays. With regard to the pending procurement action for \$785,000 of computer equipment for the DGR Regional Offices, it might be advisable to request TDY assistance from AID/W procurement to work with USAID until the PIO/C action is complete and the orders are placed.

As important as is the initiating and processing of procurement documents, equipment delivery and customs liberation pose an even more serious and fundamental problem for the project.

There are those within USAID who believe this is not a Mission problem but a GOE problem and that unless the GOE undertakes to solve it, the affected projects deserve to languish. There are other who believe that the customs problem is just another condition of underdevelopment that will eventually be resolved as the government modernizes. In the meantime USAID, while urging change, should not make all its projects hostage to that change. Those advocating that the GOE solve its customs problems believe that the U.S. Government should confront the GOE and force a change. Those advocating patience and administrative flexibility believe that confrontation will cause only bad relations, project delay or aborted projects. The future of this project under evaluation will be profoundly affected by the decision the USAID makes on this matter. The equipment requirements are an integral part of the project and its success is tied to the equipment being delivered and installed in a timely manner.

Recommendations:

- a. USAID should examine the manner in which it initiates and processes procurement actions as they relate to this project and take appropriate steps to assure that undue delays do not occur.

- b. The Mission Director should be apprised of the seriousness of the procurement problems affecting this project and prescribe remedial actions.
- c. The Project Officer should reach agreement with other USAID Officers regarding reasonable time for reviewing procurement documents, then establish a tight schedule for the processing of each PIO/C and alert the Mission Director when delays occurs.
- d. Because the liberation of imported supplies and equipment from customs is fundamental not only to his project, but touches the effectiveness of practically all USAID activity, it must be addressed by the Mission Director and if necessary brought to the attention of the U.S. Ambassador. It is beyond the scope of this evaluation to suggest solutions to the problem. But it must be observed that until it is resolved, this project will operate at a heavy disadvantage.
- e. The Mission will have acted negligently unless it has assured itself ahead of time that it can obtain customs clearance in a timely fashion for the \$785,000 of computer equipment about to be ordered.

C. STUDIES

1. Revised Procedural Laws and Regulations

Target:

By end of year 2, a study of a revised revenue code and procedural tax laws completed and approved by Minister of Finance.

Inputs:

None under project. To be undertaken by MOF.

Status as of July 31, 1987:

No action has been taken to date.

Target Achievement:

On signing the Project Agreement the GOE committed itself to: "Form an internal working group in the Ministry of Finance to conduct a study of laws and regulations pertaining to tax payment procedures and develop recommendations for changes. The Minister of Finance will take prompt executive action, within his authority, to effect changes in accordance with these recommendations. Where legislative changes are recommended, the Ministry of Finance will make its best efforts to ensure that these recommendations are acted upon and made law by the Ecuadorean legislature at the earliest possible opportunity."

The PP states that prior IRS studies and the pilot project confirmed that the procedural aspects of Ecuadorean tax laws and regulations contain many provisions that unduly favor the taxpayer, hinder tax administration and discourage compliance. It also states that the MOF would undertake a comprehensive study of the Revenue Code (which contains only procedural law) and the procedural aspects of substantive tax laws and regulations. The purpose of the study was to recommend changes that would strike a

better balance between the rights of the taxpayer and the right of the Government to collect taxes. The PP concludes that while the recommended changes coming from such a study were not essential to the success of the project, their enactment could enhance its effectiveness and efficiency.

The Director of the DGR in explaining why no action had been taken to initiate a study of the tax code stated that reform of either tax law or the tax code was a decision beyond the authority of the DGR. He also said that in order to undertake a study, a team of professionals would have to be brought together and that there were no funds available to carry out this activity.

Conclusions:

Most professionals reviewing Ecuadorean tax administration concur that the goals of the Fiscal Administration Development project would be greatly advanced by the thorough overhaul of the procedural aspects of Ecuadorean tax laws. The Director General of Revenues is correct that the decision to initiate studies in this area must come from the Minister. Nevertheless, the DGR is the only office in the MOF that has direct knowledge of the specific problems that the current tax code and regulations pose for a more efficient and equitable tax collection system. It is within the present authority and competence of the DGR to prepare draft revisions in the code and to recommend other changes in it. Since the Government has committed itself under this project to carrying out the study and since it is still considered an important activity under the project, it is in the interest of the DGR to assure that it has a central role in whatever studies are undertaken. Therefore, rather than being surprised by such a study being initiated somewhere else in the Ministry, the DGR should take the leadership.

Recommendations:

- a. The requirement under the Project Agreement that the MOF carry out a study of the tax code should be brought to the attention of the Minister of Finance. The USAID should take every opportunity to remind the Minister and Ministry personnel of the importance of such a study.

b. The DGR should begin to do internal studies of the tax code and to encourage the Minister to constitute a study commission to recommend changes in the code.

## 2. Revenue Sensitivity Analysis

### Target:

Analysis Completed in year 1.

### Inputs:

U.S. Studies Consultant (6 p/m).

### Status as of July 31, 1987:

Study completed September 1986.

### Target Achievement:

Syracuse University was contracted under the project to carry out this study. Two papers were prepared. The first by Jorge Martinez entitled "Sensitivity Analysis and Evaluation of Ecuadorian Personal Income Tax." The other by Hernando Garzon entitled "The Income Tax in Selected Latin American and Caribbean Nations: A Cross National Comparison with Special Reference to the Case of Ecuador."

The first paper analyzes some of the important implications of specific alternatives to the rate structure of the personal income tax in Ecuador. A major question, and one that the paper examines carefully, is the revenue implication of three different rate structures which could be substituted for the one currently used in Ecuador. Related issues addressed here are the burdens that might be imposed on taxpayers at different income levels and the extent to which taxpayers' compliance may be enhanced by a lower and less progressive tax rates. Also, the author's detailed examination of a sample of tax returns and audit reports has also identified a number of complications in the structure of the tax which impede its effective administration and which are not conducive to taxpayers' fulfillment of their responsibilities.

The second paper is complementary to the sensitivity analysis of the personal income tax. This study reviews the structure and performance of the income tax in fifteen Latin American and Caribbean nations. The analysis suggests that there is a certain commonality in the structure and performance of central government income taxes. In particular the author argues that while there are regional differences, the importance and productivity of income taxation is related to level of development. Also, the comparative analysis suggests that the structure of the income tax in Ecuador, while perhaps a bit more complicated, is about what would be expected given the country's level of income. However, relative to other countries, Ecuador's reliance upon, and the burden of, the tax are below what could be expected. Some of the underlying reasons for this are identified in the course of the study.

Conclusions:

These studies were completed, provided to the USAID and reproduced in sufficient numbers to be distributed to interested parties within the GOE. Copies were sent to the Ministry of Finance. However, they generated little interest or response; The first spark of interest come in the last days of July 1987, with the naming of a new Minister of Finance, who met with the authors of these studies (who are members of this evaluation team). Copies of the studies were given to new members of the Minister's immediate staff and discussions about the study recommendations ensued. It remains to be seen what additional action will be taken by the Ministry as a result of these meetings.

Recommendations:

- a. These studies are related to an eventual revision of the tax law and changes in the tax code and should be brought to the attention of whatever commission is named to study these matters.

### 3. Revenue Sharing

#### Target:

Analysis completed in year 1.

#### Inputs:

U.S. Studies Consultant (4 p/m).

#### Status as of July 31, 1987:

Study completed September 1986.

#### Target Achievement:

Syracuse University was contracted under the project to carry out this study. One paper, done by David Greytak and Victor Mendez, is entitled, "The Impact of Intergovernmental Grants on Local Government in Ecuador: A study of FONAPAR." Another done by Caroline Fawcett is entitled, "FONAPAR: An Institutional Assessment." In Ecuador the primary mechanism by which revenues collected by the central government, and the principal source of grants and aid to local government, is "El Fondo Nacional de Participaciones" (FONAPAR). The analysis in the first paper focuses primarily on the issues of whether FONAPAR has achieved the objectives set before it and on the impact of its grants on local governments.

The authors begin with a brief history of FONAPAR which suggests that the central government become more specific both in the goals to be achieved and the extent to which FONAPAR resources should be dedicated to certain objectives and areas of the country. The analysis then turns to an evaluation of FONAPAR and the effects of revenue sharing on local governments. Following this, a variety of formulas by which FONAPAR's funds could be distributed are examined and their relation to the goals of FONAPAR are evaluated. The closing section of the paper presents an overall evaluation designed to improve the revenue sharing system and enhance the performance of local governments in Ecuador.

In the second paper, the author charts out the complexity of the interrelations between FONAPAR and the Central Bank, the Treasury, the National Planning Board (CONADE), several autonomous government agencies, e.g., the National Development Bank (BEDE), the Pre-Investment Fund (FONAPRE) as well as various departments of the Ministry of Finance (MOF) of which it is a part. The paper also presents a detailed picture of FONAPAR's inter-relations with local governments and other central government institutions. This examination sets out in bold relief the complexity of the tasks set before both FONAPAR and the nation's municipal and provincial governments. Beyond this, a number of problems and difficulties are identified. Policy options, and future research are suggested.

Conclusions:

As with the Sensitivity study, these studies were completed and reproduced in sufficient number for distribution to interested parties, copies were made available to the new Minister of Finance and his team at the end of July 1987. It remains to be seen what use will be made of them.

#### 4. Design of Improved Customs Revenue Collection System

Target:

Study completed in year 1. Plan for further action approved by MOF in year 2.

Input: U.S. Studies Consultant (10 p/m).

Status as of July 31, 1987:

Study completed May, 1986. No action forthcoming from MOF in year 2.

Target Achievement:

The study "Ecuador: Design of an Improved Custom Collection System" by Ken Stacey covers the regulation, operation and imposition of Customs. The analysis, finding and recommendations of this report are the product of ten months' effort which involved extensive field work including interviews and observations at all levels of the Customs operations. The author focuses primarily on where and how the regulation and imposition of customs duties could be improved. The paper concludes with an extensive list of recommendations classified into the subjects of organization, operations, and computerization.

Conclusions:

As with the other studies, this report was provided to the USAID in sufficient copies for distribution. There has been a spark of interest from the new Minister of Finance in this study but it remains to be seen what will come of it.

D. General Advisory Support

The general advisory support under the project is the responsibility of the Contractor, who agreed to furnish a full-time chief of party, short-term advisors as required and a local administrative assistant to provide logistical and administrative services.

The Contractor has performed well in this area providing not only the staff specified under this project element, but specialized staff for other project elements. Approximately four full-time staff members (including party chief) have been in-country throughout the first two years of the project. The Contractor and staff are located in the DGR offices, they have established an easy working relationship with their local counterparts and have the full confidence of the Director General and his staff.

Conclusion:

The Chief of Party has been able to provide excellent general advisory support for the project. While the present Chief of Party is about to depart after a two year tour, he is being replaced in a timely fashion by another experienced tax advisor. So it is to be expected that the high level of general support provided by the Contractor will continue.

**ANNEXES**

**Annex 1: People Interviewed**

**Annex 2: Documents Consulted**

ANNEX 1

PEOPLE INTERVIEWED

Mr. Thomas Chapman	AID Project Officer
Mr. William Newnam	Omnimax Chief of Party
Mr. James Westrick	Omnimax Processing System Advisor
Mr. Marion Coburn	Delinquent Collections and Returns Compliance Advisor
Mr. Arthur Trevino	Audit Advisor
Dr. Rodrigo Espinosa	Minister of Finance
Sr. Rodrigo Garces	Director General of Revenues, DGR, MOF
Dr. Carlos Velasco	Ministry of Finance, DGR Fiscal Administration Project Coordinator
Sr. Virgilio Rivadeneira	Sub-Director General Determinacion Tributaria
Sr. Alfonso Burbano	Sub-Director General Procesamiento y Recaudacion
Sr. Galo Almeida	Sub-Director General de Control Tributario
Sr. Gonzalo Rodriguez	Chief Dept. de Programacion y Control, de Determinacion Tributario.
Sr. Arsenio Hidalgo	Chief Dept. Procedimiento y Tecnicas
Sr. Fernando Pineda	Chief Dept. Programacion y Control Procesamiento y Recaudacion
Sr. Victor Chacon	Chief Dept. Sistemas y Procedimientos Procesamiento y Recaudacion
Sta. Aida Villacres	Chief Dept. Planificacion Tecnico, Administrativo
Spa. Pilar Almeida	Chief Seccion de Estadistica Dept. de Planificacion
Sr. Jose Cabegas	Chief Dept. Normas y Tecnicas de Cobro
Sr. Arnando Friery	Project Adm. Asst.
Sr. Segundo Vargas	Collection Agent
Sta. Carmen Lopez	Collection Agent

GUAYAQUIL REGIONAL OFFICE

Sr. Franklin Rodriguez	Chief Dept. de Determinacion Tributario-Guayaquil
Sr. Alamagro Velasquez	Chief Dept. de Procesamiento y Recaudacion, Guayaquil
Sra. Soraida Leon	Chief Dept. de Control Tributario, Guayaquil
Dr. Espinosa	Chief Oficina de Reclamos, Guayaquil

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ANNEX 2

DOCUMENTS CONSULTED

Project Paper - Fiscal Administration Development Project 518-0042, Loan 518-V-061

Project Loan and Grant Agreement, March 29, 1985

Omnimax Contract Proposal

Omnimax Contract

Omnimax Quarterly Reports

Omnimax Chief of Party Monthly reports

Omnimax Semi-Annual Reports

AID Semi-Annual Evaluation Reports

PIO/C50161, 50164, 50179, 50181, 50182, 50184

Ministry of Finance - Plan Operativo - 1985, 1986, 1987

Registro Oficial, October 9, 1986 - Ministry of Finance Reorganization of DGR

DGR Quarterly Evaluation for first quarter, 1987

DGR Plan de Proyectos Anual para 1987

DGR Manual Interno para el Uso, Manejo y Custodia de la Documentacion del Archivo General de Rentas October 30, 1986.

DGR Manual Interno para la Administracion de Documentos y Archivo de la Secretaria de Documentos y Archivo de la Secretaria General de Rentas, December 22, 1986.

DGR Instructivo para la Administracion y Control de la Reproduccion de Documentos, April 20, 1987.

DGR Manual de Recuperacion de valores Exigibles

DGR Manual de Control de Cumplimiento de las Obligaciones Tributarias

DGR Manual de Asistencia Coactiva y Procedimientos Afines

DGR Proyectos de Formularios e Instructivos

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