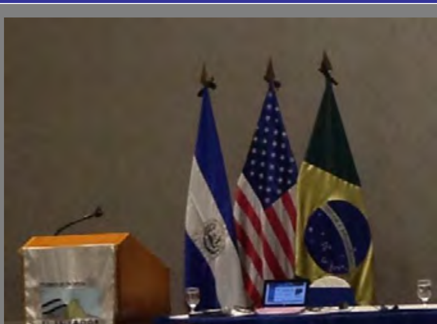
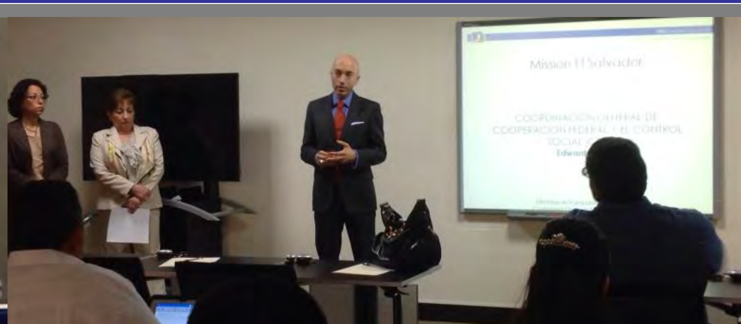
# El Salvador Fiscal Policy and Expenditure Management Program (FPEMP)

## Third Year Evaluation Report

**June 2013 – June 2014**





**July 2014**

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# FISCAL POLICY AND EXPENDITURE MANAGEMENT PROGRAM (FPEMP)

## THIRD YEAR EVALUATION REPORT
## June 2013 - June 2014

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| **Program Title:** | **Fiscal Policy and Expenditure Management Program** |
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# ACRONYMS

| | |
|---|---|
| AECID | Spanish International Cooperation |
| AMT | Alternative Minimum Tax |
| COMPRASAL II | e-procurement system |
| CSMS | Case Selection Management System |
| DAI | Development Alternatives Incorporated |
| DFDMH | MOF Training and Human Talent Development Department |
| DGA | Customs General Directorate |
| DGCG | General Directorate for Government Accounting |
| DGII | General Directorate for Internal Revenue |
| DGP | Budget General Directorate |
| DGT | Treasury General Directorate |
| DINAFI | National Directorate for Financial Administration |
| EU | European Union International Cooperation |
| FPEMP | Fiscal Policy & Expenditure Management Program |
| GDP | Gross Domestic Product |
| GIZ | German International Cooperation |
| GOES | Government of El Salvador |
| IDB | Inter-American Development Bank |
| IMF | International Monetary Fund |
| IPSAS | International Public Sector Accounting Standards |
| IVP | International Visitors Program |
| MOF | Ministry of Finance |
| OTA | Office of Technical Assistance of the United States Treasury |
| PAAC | Annual Procurement Plan module |
| PFG | Partnership for Growth |
| SAFI | National Financial Management System |
| SIRH | Human Resources Information System |
| SITEP | Treasury Revenue System |
| TCA | Taxpayer Current Account |
| TRS | Taxpayer Registration System |
| TSA | Treasury Single Account |
| UNAC | National Procurement Unit |
| USAID | United States Agency for International Development |
| WB | World Bank |

# EXECUTIVE SUMMARY

This Third Year Evaluation Report reviews the Government of El Salvador (GOES)'s achievements in advancing its fiscal reform agenda, through assistance from the Fiscal Policy & Expenditure Management Program (FPEMP), funded by the United States Agency for International Development (USAID). The FPEMP formally began on June $10^{th}$, 2011, and is currently entering the fourth and final year of the contract, although an optional fifth year is a possibility. The Ministry of Finance (MOF) does not only benefit from FPEMP's technical assistance for fiscal reform, but also from other bilateral and multilateral organizations, including the German International Cooperation (GIZ), European Union International Cooperation (EU), International Monetary Fund (IMF), Inter-American Development Bank (IDB), World Bank (WB), Spanish International Cooperation (AECID) and the U.S. Treasury's Office of Technical Assistance (OTA).

The MOF's National Directorate for Financial Administration (DINAFI)—the entity assigned to coordinate donor activities for fiscal reform in El Salvador—works in conjunction with international donors, following a detailed matrix of activities and critical path, aiming to avoid duplication of efforts and to ensure that the goals and objectives of the reform are on track. While the first year of the FPEMP was highly consumed by such process of donor coordination and uncertainty on the specific tasks each donor would support, by the second year, these tasks had been clarified resulting in important progress and project outputs.

In the third year, the GOES achieved important outcomes in revenue mobilization, public financial management and fiscal transparency. At the same time some activities experienced some delays due to the electoral calendar, where the MOF announced the delay in the formulation of a programmatic budget from 2015 to 2017. During this review, GOES counterparts admitted full responsibility for any delays in the schedule of activities, and praised USAID's assistance through FPEMP as timely, effective, results-driven, and flexible. Particularly, in FPEMP's third year, the GOES ran into significant challenges with the implementation of the National Financial Administration System (SAFI) II and the e-procurement system (COMPRASAL) II development—tasks previously assigned to different donors—where FPEMP was able to step-in assisting the GOES to ensure continuity and avoid implementation failure. The FPEMP adapted and adjusted resources time and again, gaining significant recognition by MOF' high level officials who were highly grateful during interviews and referring to the FPEMP team and its leadership as "the best assistance received".

President-elect Salvador Sánchez Cerén took office as of June 1, 2014, continuing the Partnership for Growth (PFG) initiative with the United States, a key driver of the fiscal reform process. Going forward will not be faced without challenges, however, which is expected from the complex nature of a comprehensive fiscal reform process currently underway. While the tax revenue mobilization component continues to be on track, slow economic growth continues to limit achieving the 16% of tax to Gross Domestic Product (GDP) target set by the GOES by 2015. The private sector outreach component has also made important progress towards achieving greater fiscal transparency, including the recent addition of fiscal transparency activities at the municipal level through the international initiative between the Governments of the United States, El Salvador and Brazil. The prospects of forging a fiscal pact in the first three years of the program dissipated, but with a change in government (though still FMNL-led government), a new opportunity arises for FPEMP to support the GOES enactment of a fiscal pact.

The public expenditure management component faces the most challenges going forward, as experience so far has demonstrated critical delays in activities related to supporting the General Budget Directorate (DGP), entailing an administrative and functional modernization, the budget modernization, and advancing towards the formulation of a programmatic budget. FPEMP assistance to the DGP intensified during the third year as the GIZ completed its assigned technical assistance tasks, but not without delays. There are important changes in the budget practices that will require, in some instances, structural changes to ensure a sound, lawful budget process. Additionally, during this performance review, the MOF acknowledged delays in this area and admitted full responsibility for such delays, which include among others, delays in document approvals, delays in submitting input information, as well as lack of a dedicated counterpart team that can push such demands. Nevertheless, these challenges have already been discussed among the Vice Minister of Finance and the donors assisting in this area, and a steadier timeline and set of commitments from the counterparts constitutes a new plan for achieving important milestones in this budget reform area going forward.

Technical assistance to the GOES' fiscal reform agenda from USAID's FPEMP has made important contributions to the achievements of the GOES's objectives identified in this report; nonetheless and when applicable, assistance from other donor programs is identified throughout the report. While some program outcomes are not always easily quantifiable, we make an effort to carefully attribute these achievements, through measurable ways (qualitatively and often quantitatively) providing important data on results. This Third Year Evaluation Report highlights achievements in the three areas of FPEMP's assistance, including: public expenditure management, tax revenue mobilization and private sector outreach.

**Objective 1: Improved Public Expenditure Management**

- **Implementing a Treasury Single Account (TSA):** A diagnosis of treasury operations in year one of the program highlighted important deficiencies in the cash management function leading to inefficient management of tight cash flows, including the existence of more than 1,600 bank accounts and approximately $25 million in idle balances. Since November 2012, the Treasury General Directorate (DGT) is operating under the new real-time gross settlement system—a real time payment system—contributing to modernizing cash flow management and payment transactions of government obligations. The vendor payment transaction time has been reduced from an average of 10 days to approximately 2-3 hours. As of May 2014, 23 out of 25 institutions are already operating under the TSA system. Additionally, the GOES achieved integration of 96 percent of the 11 different commercial banking institutions (the treasury's payment agents) with the Central Bank and TSA system. As of May 2014, the treasury subsystem's 82 use cases which serve as the basis for software development and integration into SAFI II have been completed and are under review.
- **Adopting International Public Sector Accounting Standards (IPSAS):** IPSAS aim to improve the quality of general purpose financial reporting by public sector entities, leading to better informed assessments of the resource allocation decisions made by the government, thereby increasing transparency and accountability. FPEMP's government accounting experts worked with the General Directorate for Government Accounting (DGCG) on preparing the adoption strategy—undertaking a detailed gap analysis to identify key accounting and reporting issues, assessment of the chart of accounts, documenting

accounting norms and policies and the strategy to develop accounting manuals, and developing a detailed work plan to manage the full IPSAS conversion. As of May 2014, the GOES enjoys a new chart of accounts containing over 6,000 accounts and subaccounts, up from 1,000 previously developed in compliance with international public sector accounting standards. Additionally, the government accounting subsystem's 5 (out of 25) use cases have been completed serving as the basis for software development and integration into the SAFI II. Additionally, FPEMP brokered the approval for using Costa Rica's manual of accounting policies and procedures as the basis for developing the Salvadoran accounting manual, helping to save time and effort. Developing such manual is still pending.

- **Modernizing the Public Financial Management and the SAFI II:** With FPEMP assistance, the GOES achieved the development of the conceptual model for the new budget and financial management system—presenting an integral platform for the modernization of the entire budget process, and strengthening the institutional capacity of the agencies involved for implementing a results-based budgeting system. The new SAFI II brings together various functions including: budgeting formulation, treasury, public investment, budget execution and accountability, procurement, human resources and asset management. The FPEMP team supports the implementation of the SAFI II by supporting the development of the system requirements (use cases) for software development of the budget execution module, the treasury and the public accounting subsystems. FPEMP will also support a step further in software development, code generation, for the treasury subsystem and the budget formulation and the public accounting subsystems. The FPEMP team supports the MOF's DINAFI in the implementation of the SAFI II, after the GOES (jointly with the World Bank) decided to follow a custom-built system approach, which was decided to be the best choice for the GOES rather than purchasing and customizing a commercial-off-the-shelf system.
- **Advancing the implementation of a multi-year, results-based budgeting system:** The goal is for the GOES to establish the foundations that will enable the formulation of a programmatic budget for fiscal year 2017 (delayed from a previous 2015 target). The budget modernization project is based on building four main pillars, including implementing a programmatic budget that focuses on results; implementing of a multi-year institutional and budget framework; developing a system for monitoring and evaluation of budget performance; and enriching (human and institutional) capacities within the public sector. USAID and the GIZ are assisting in building the elements required for the successful implementation of such system. With FPEMP's assistance in the second year, the DGP now has a detailed plan for an optimal functional and organizational structure—one that supports the attainment of results and places special emphasis on monitoring and evaluation, a new key role for the DGP. In the third year, the FPEMP team took on the task of developing use cases for development of the budget execution module of the SAFI II. In doing so, however, FPEMP budget experts identified important issues/challenges in the budget execution programming (PEP—*Programación de la Ejecución Presupuestaria*) methodology, which carries important legal and operational implications for the GOES budget process. Solving such issues is key in proceeding with the budget modernization effort and the FPEMP team has developed a proposal for the PEP's Modification, which is currently under review. Once these issues are solved FEPMP will continue supporting the development of use cases for the budget execution module. Additionally, going forward, FPEMP will support the implementation of the programmatic budget in three sectors, including Health, Agriculture and Economy. Work in this area is expected to commence in October 2014.

- **Enhancing the e-procurement system, COMPRASAL II:** Joining the IDB's technical assistance, in the third year, FPEMP's programmers assisted the GOES' National Public Procurement Unit (UNAC) with meeting demands for software development of the new electronic procurement platform. Facilitating greater transparency and efficiency in the public procurement process, FPEMP supported the development of 1 out of 5 modules of the COMPRASAL II in the third year—the Annual Procurement Plan module (PAAC—*Plan Anual de Adquisiciones y Compras*)—which is scheduled to begin implementation through training and capacity building in June 2014. FPEMP supported the PAAC's software development helping reinstate continuity of activities, while fulfilling delivery timeliness through the use of "extreme programming" methodology, achieving agile software development with the practice of pair programming in short development cycles. FPEMP will further support the development of the remaining modules in the final year.

**Objective 2: Tax Revenue Mobilization**

- **Mobilizing greater tax revenues:** Tax (net) revenue collections augmented by 30 percent from 2010-13. Relative to GDP, tax revenue increased from 13.5% in 2010, 13.8% in 2011, 14.4% in 2012 and 15.4 % in 2013, nearly a two percentage point increase relative to GDP since the beginning of the program. A tax reform approved and signed into law on December 16, 2011, included a package of progressive tax modifications, intended to collect and additional $150 million per year to fund the administration's increases investment for the new social programs (health, education and employment programs).[1] While there was an increase of 0.6 percentage points in tax-to-GDP in 2012 when the tax reform was implemented, in 2013—two years after the tax reform—the DGII experienced the highest increase in tax collections since the 2004 tax reform collecting an additional 1 percent of tax to GDP. Although the DGII does not have a microsimulation model that can more accurately inform gains in tax revenue due to the changes in tax provisions, this evaluation can attribute at least $26.2 million directly mobilized by the new CSMS II through the fiscal compliance, fiscal audit modules, and treasury call center. Tax collections in 2013 surpassed those in 2012 by $71 million, that is, 37% of the additional revenue collected. The CSMS II currently supports the control, traceability, and workflows of approximately $97.3 million of revenue collected in 2013. The CSMS II fiscal compliance module was launched in 2012 and the tax audit module in 2013.
- **Improving collection of delinquent taxes:** Following the success of the Call Center at the General Directorate for Internal Revenue (DGII)—created with USAID's assistance through the predecessor Tax Policy Administration Reform program—FPEMP supported the DGT to set up a Collections Call Center to tackle tax arrears. Established in August 2012 and after only 9 months of operations, the Treasury Call Center has helped mobilize over $3 million from tax arrears and income tax resolutions.
- **Improving the Large Taxpayers' Office:** Refocused the scope of the large taxpayers' office from 3,569 to the largest 661 taxpayers. FPEMP assistance included establishing a renewed,

[1] The reform passed in December 2011 and effective in 2012, eliminated income taxes for people making less than $503 a month, benefitting more than 262,000 people. Those with a monthly salary between $503 and $6,200, approximately 250,000 people, saw their income tax reduced from 30% to 25%. In contrast, business income taxes increased from 25% to 30%, except for companies with revenue less than $150,000, who will continue to pay 25%. The reforms also create a new 5% tax on all dividends paid by businesses to stock holders, the first time shareholders in El Salvador will be responsible for paying such taxes (CISPES, 2012).

one-stop-shop for large taxpayers which brings together the control, collections and taxpayer service functions, thus integrating the front office transaction desks, back office transaction desks (for more complex issues), as well as a DGT collection stand. Additionally, FPEMP assisted with the implementation of the large taxpayer office's auditors' area. This area houses 88 auditors' work stations, supporting greater revenue mobilization through audit. Nearly $2 million of additional tax revenue identified and collected by the large taxpayer office' transfer pricing unit in 2013-14.

- **Lowering compliance costs of small and medium taxpayers:** FPEMP supports improvements in tax compliance for large, medium and small taxpayers through the Case Selection Management System (CSMS), but additional support is granted to improve taxpayer services for small and medium taxpayers. The self-service kiosk system is an initiative providing instant services for different processes including: tax account inquiry, payment status for Value Added Tax, requests for tax transcript statements or solvency statement, information on the tax calendar, and other taxpayer services. Services available at the kiosks help taxpayers avoid long lines at the DGII thus reducing compliance costs for both taxpayers and the tax administration. A total of 18,334 transactions were processed in 2013 through the service kiosks.
- **Updating the Taxpayer Registry System (TRS) and Taxpayer Current Account (TCA):** The TCA of the Salvadoran tax administration suffered many deficiencies, needing to be cleaned, updated and upgraded in the tax administration information system. By October 2013, the TCA Cleaning Project completed the cleansing of 21,523 records, of which 273 were large taxpayers, completing 100 percent of the total records assigned by the MOF to FPEMP. By the end of 2013, the TRS Cleaning Project completed the cleansing of 7,730 taxpayer records, while replacing Tax Identification Number cards of all these taxpayers while eliminating 610 cases of duplicity. A permanent TRS and TCA cleaning unit has been institutionalized at the DGII, which will continuously cleanse records while safeguarding future pollution.
- **Rigorous and Fair Audits:** A centerpiece of USAID's assistance to the DGII through the predecessor Tax Policy Administration Reform program was the development of an automated, risk-based CSMS. The CSMS I became fully operational in January 2010 reducing tax officials' discretion in the audit selection process and improved transparency and efficiency in case management. FPEMP is providing continuity by supporting the upgrading to a new CSMS II. The CSMS II integrates customs information with tax revenue, to improve the risk methodology, enabling better and more productive audits. Additionally, the CSMS II expands beyond the audit and control areas providing case management capabilities to two new units, the Fiscal Compliance and the Value Added Tax refunds units. The end result of a complete CSMS II is to expand case management capabilities through all stages of the audit process, including taxpayer hearings, administrative appeals and judicial appeals. Important results were achieved in the third year of FPEMP assistance, including:
    - The fiscal compliance module of the CSMS II, in 2013, allowed the contacting of 19 thousand taxpayers with inconsistent records (including 6,228 collection email notices in less than 12 hours, 8,931 collection letters in less than 3 days, 2,022 collection calls), helping produce an additional $1.2 million in additional tax revenue (more than US$131,000 from small taxpayers and over US$700,000 in income tax collected during the first 3 days).

- During tax season in 2014, the fiscal compliance and the newly functioning audit modules of the CSMS II, allowed the contacting of over 27 thousand income taxpayers through a preventive campaign using suggested tax declarations (including 17,209 salaried employees with tax liabilities greater than $3, and 10,020 legal persons and personal income taxpayers with diverse income), helping boost tax revenues by $12.4 million.
- Massive tax audit cases processed through the CSMS II generated $2.6 million in additional revenue in 2013, and $2.1 million in the first 4 months of 2014.
- Through the CSMS II, the portfolio management unit ("*gestion de cartera*") has reduced the amount of cases processed in the field from 70% to 30%, thus reducing administrative costs, improving targeting and productivity.
- In the past various errors were found in the calculation of amounts withheld by retention agents from salaried employees—most of which applied as definitive tax payments—generally lesser amounts than what should have been withheld. The CSMS II has facilitated more accurate calculation of tax withholdings, producing $10.7 million in additional tax withholdings and therefore in additional tax revenue.
- The CSMS II facilitated the reduction of 265,746 tax refund transactions from 2012 to 2013. The DGII estimates that each transaction costs $5.65 to process; that is a $1.5 million in administrative cost savings.

**Objective 3: Private Sector Outreach**

- **Tax Awareness program for Youth:** Launched in March 2013, the EXPRESATE center, or to "express yourself," is an initiative that teaches future taxpayers that tax compliance is a social responsibility that—in the long term—fosters economic growth and social development of the country. Targeting high school students between the ages of 15 and 20, the EXPRESATE center hosts hundreds of students monthly through its state-of-the-art facility featuring interactive walk-through exhibits, including a dramatic look at the country's stance without tax revenue in the "Hall of Evasion." This project—the first of its kind in Latin America—, is a unique opportunity to foster fiscal responsibility among the young Salvadoran population. The FPEMP team supported the development of curricula and materials, installation and furnishing of the facilities, establishment of a computer lab, and purchase of modern video and audio equipment. The Ministry of Education is a partner to the MOF in the operations. As of June 2014, 3,217 students have visited the EXPRESATE program. Additionally, in the third year, FPEMP facilitated the implementation of a mini-EXPRESATE during an open PFG event, thus opening the opportunity to create a mobile strategy that would not discriminate by age, but instead would extend the outreach beyond the youth, providing yet another platform for promoting tax awareness and fiscal responsibility among Salvadorans.
- **Promoting fiscal transparency at all levels of government:** Following the passage of the Access to Public information Law in December 2011, efforts to promote fiscal transparency in El Salvador are underway. The GOES, through the President's Transparency Division, and the MOF, are committed to demonstrating greater fiscal transparency in the management of public resources. Despite El Salvador's improvement in the Open Budget Index score from 28 in 2006 to 43 in 2012—categorized by the International Budget Partnership as one of the

greatest improvers during this period—budget information is still limited.[2] FPEMP's assistance has focused on revamping the MOF's fiscal transparency portal to provide up-to-date, real time budget information. In the third year, FPEMP facilitated the launching and implementation of the International Trilateral Initiative on Fiscal Transparency between the Governments of El Salvador, the United States and Brazil, aiming to promote fiscal transparency and implement best practices for the GOES. Additionally, fiscal transparency efforts were expanded to the municipal level, within the framework of the International Trilateral Initiative, to promote fiscal transparency and citizen audit mechanisms at the local level in El Salvador. The program in coordination with the Brazilian counterparts trained 50 GOES staff on best practices on fiscal transparency, including workshops in El Salvador as well as an International Visitor's Program (IVP) to Brazil. The FPEMP team continues to support the launching of an enhanced fiscal transparency portal—expected December 2014—which will include a site for municipal data and social audit mechanisms.

- **Building a stronger administration through improved human resource utilization:** The FPEMP program supports the MOF's training department, and the public financial management reforms underway, through a program aimed at improving human resource utilization. The goal is to improve the operational efficiency and productivity of professional staff, strengthening their technical capacities, outlining a clear professional career path, improving employee's performance evaluation, and providing capacity building and training for professional development. The process follows the Competency Based Methodology for Human Resource Management. This methodology is used to integrate all human resources functions with the role of creating a central basis for recruitment and selection, placement of employees, training and development of employees, performance management, career management, promotions, and remuneration. Three hundred fourteen (314) employee profiles assessed and updated applying the Competency Based Methodology. Challenges ahead in this area include overcoming opposition from the employee union—although involved from the beginning of the process—has demonstrated resistance to the change. The MOF has commitment to devising a strategy for overcoming such challenges in the next few months.
- **Transforming the MOF Training and Human Talent Development Department (DFDMH) into a Center of Excellence:** FPEMP supports activities for transforming the DFDMH, into a Center of Excellence. The DFDMH is an important vehicle for implementing all training related to the curricula development under the new Human Resource System. FPEMP focused in the second year on delivering training on curricula development, thus facilitating the implementation of the new MOF's Human Resources System. In the third year, FPEMP continues assisting the DFDMH, following up on curricula development and training activities, also as part of the human resource modernization project.
- **Supporting the implementation of a fiscal sustainability agreement.** In the third year, FPEMP presented to the GIZ and AECID a proposal for the development of a White Paper on Fiscal Sustainability Agreement for El Salvador instead of the reused term "Fiscal Pact". The document would be submitted to the incoming Salvadoran Government to aid in the creation of an agreement with the private sector and civil society to address the complex fiscal environment the country is facing. The FPEMP team is contributing to the fiscal

[2] Improving the OBI score would require the GOES' publishing pre-budget statements, a mid-year budget review, and allowing public access to audit reports. Open Budget Index report 2013.

projections and the design of revenue related policies facilitating fiscal sustainability in the medium and long term.

This third year evaluation report contains a number of quantitative and qualitative indicators that help monitor progress towards achievement of results, as presented above. Additionally, each chapter of this report, related to each of the three areas FPEMP supports, contains a list of challenges to watch for and to overcome in the time going forward.

As FPEMP and other donor projects approach their end date, it is important to consider the GOES' need for continuous assistance during the fiscal reform process which is well underway. Prior USAID investment in fiscal reform in El Salvador through TPAR and other predecessor projects have produced high rates of return on investment, through revenue mobilization, efficiency gains, and government effectiveness, and FPEMP is not an exception. As revealed by important results quantified in this report, coupled with the multi-donor effort for supporting the GOES, this time represents a unique, critical opportunity for consolidating public finances through implementing sound public financial management in El Salvador.

USAID and the FPEMP team should continue to work in close coordination with the government counterparts and other donor assistance programs to ensure the GOES' continuous, sustainable progress towards results, relying on much needed technical assistance to overcome the complex nature of the reform as well as the challenges identified in this report.

# INTRODUCTION

## Background and Purpose

This report reviews the third year of the USAID-funded FPEMP, reviewing activities and key program results, identifying factors that facilitated or impeded achievement of results, identifying challenges and recommending options for accomplishing and/or accelerating results and impact in the current and future years. The report also serves as reference point for most of the various forms of assistance the FPEMP has rendered over the three years of operations.

FPEMP formally began on June 10, 2011, when USAID and Development Alternatives Incorporated (DAI) signed the contract. The program is for four years with an optional fifth year. FPEMP's four-year period concludes on June 9, 2015.

Implemented by DAI, FPEMP contributes to achieving the objectives of El Salvador's Five Year Anti-Crisis Plan and those of the MOF: namely, to improve the efficiency of public expenditure management, enhance tax administration and mobilize greater tax revenues, and improve public-private relations in order to accelerate economic growth. In this context, FPEMP supports the MOF to transform the GOES into a high-performing, result-driven administration that taxes citizens fairly, spends money wisely, and promotes greater social inclusion.

## Structure of the report

This introductory chapter includes a discussion on the background, purpose and methodology used to prepare and review the report. The next chapter provides an overview on the program's goal and recent economic and fiscal developments in El Salvador. Next are three separate chapters, one for each program objective. The final chapter provides findings and recommendations for next steps.

## Methodology

This evaluation report is the outcome of detailed review of documents, technical studies, data and program progress reports as well as consultation and interviews with many persons engaged with the FPEMP, including USAID/El Salvador, program team members, and Salvadoran counterparts from the MOF. All major counterparts who have collaborated with and benefited from FPEMP assistance in the third year—including several individuals and units of the MOF—were interviewed for the purpose of this evaluation. **From the DGII:** General Directorate, Large Taxpayers Office, Tax Analysis Unit, Case Selection Unit, Portfolio Management Unit, IT Unit, and Taxpayer Registry and Taxpayer Current Account Division. **From other Directorates of the MOF:** DGT, DGCG, DGP, UNAC, MOF General Administration Directorate, and DINAFI.[3]

This report is based explicitly on the Annex 1 Results Matrix at the end of the report. This annex was developed to reflect the program's work plan, quarterly FPEMP Progress Reports, the Performance Monitoring Plan (PMP), and other program generated information. This report is based on the program's objectives, expected results, achievements, and work product or

[3] For a complete list of persons interviewed and consulted, please see Annex 2.

deliverables. The program outputs reported in Annex 1 are limited only to those that have had immediate impact on helping counterparts to achieve the improvements included here.

Throughout this report, accomplishments are supported with quantitative indicators wherever possible, but to ensure broad capturing of achievements, we also include qualitative information. This includes quotes from counterparts, reports in newspapers (if any available), and/or policy statements from the government.

## USAID Strategic Objective and FPEMP Goal

El Salvador and the United States have embarked on a PFG to mobilize resources of both governments to remove obstacles and identify opportunities for broad-based economic growth in El Salvador. The PFG is a bilateral collaboration based on a focused and deliberate strategy to generate the greatest possible impact of joint development efforts, as detailed in its Joint Country Action Plan 2011-2015. El Salvador is one of only four countries worldwide, and the only one in Latin America, with which the United States is developing this partnership.

One of PFG's main objectives is to engage governments, the private sector and civil society with a broad range of tools to unlock new sources of investment, including domestic resources and foreign direct investment.[4] FPEMP has been designed to support the achievement of USAID's objectives through the PFG initiative, following Goal 4 (from constraint 2): Raise (net) tax revenues to 16 percent of GDP by 2015 and use public resources efficiently and transparently. Likewise, FPEMP's goal is to "create a stable macroeconomic environment that fosters inclusive, broad-based economic growth through enhanced transparency, accountability and more efficient use of public resources." The program goal is expected to be achieved, in part, by reaching the three program objectives discussed next. To simplify this goal, the next chapter is devoted to analyzing the goal of achieving a "Stable Macroeconomic Environment."

FPEMP has three explicit objectives comprised in three project components. These objectives are as follows:

**Objective 1:** Enhanced public expenditure management (through improved efficiency in the use of resources and stronger public financial management)

**Objective 2:** Improved revenue mobilization (through sound tax policy and better revenue administration)

**Objective 3:** Strengthened private sector engagement (through greater outreach and enriched communication mechanisms)

The three components work areas are:

**Component 1:** Public expenditure management

**Component 2:** Tax revenue mobilization

**Component 3:** Private sector outreach

[4] Information available from the U.S. Department of State website, Partnership for Growth Factsheet available online at http://www.state.gov/r/pa/prs/ps/2011/11/177887.htm

Each of the components has a team that works with a defined annual work plan, with dedicated staff embedded within counterparts' facilities. The program's cross-cutting team, including program management and administration, outreach, and Information Technology (IT) helps ensure that FPEMP's component teams have the tools and support necessary to meet the program's objectives and expected results.

## Expected Results, Achievements and Delivered Outputs

The expected results presented in this report follow the expected results from FPEMP's work plan, which follow the results expected per the program's contract. These are results anticipated to arise from counterpart's achievements which directly support program objectives. While many factors can affect the achievement of the expected program objectives and results, by evaluating achievements and delivered outputs on an annual basis, it is possible through this annual evaluation to ensure a more systematic review of any challenges while devising a strategy which can keep program activities on track in progressing towards achieving its objectives and expected results.

All achievements mentioned in this report are attributed to the counterpart agencies in the MOF and the GOES. Achievements are changes in behavior or capacity of counterparts, improvements to laws or regulations or processes that have a direct impact on results. These achievements are not claimed as FPEMP's output, but they support program objectives and results, and are promoted by FPEMP's support and resources. Additionally, not all of FPEMP's counterparts' achievements might be documented in this report. Instead, the report focuses on achievements that have a direct relationship to both the program's objectives and results.

USAID-funded FPEMP provides a variety of outputs including: technical assistance, human and institutional capacity building, IT and other equipment, systems, advisory assistance, outreach mechanisms, technical reports, and advocacy that altogether help support counterparts' achievements and improvements that lead to expected results.

## International Donor Assistance and Coordination

The GOES is advancing its fiscal reform agenda with support from multiple international agencies. The DINAFI, in coordination with other units of the MOF, leads the efforts of international assistance coordination from:

- USAID
- GIZ
- EU
- IMF
- IDB
- WB
- AECID
- OTA

# GOAL: A STABLE MACROECONOMIC ENVIRONMENT[5]

This chapter provides an overview of recent economic and macro-fiscal trends in El Salvador. The ultimate goal for USAID-FPEMP is to create a stable macroeconomic environment that fosters inclusive, broad-based economic growth through enhanced transparency, accountability and more efficient use of public resources. Such goal requires reviewing recent macroeconomic developments and the economic outlook, including political economy aspects of reform, providing context for the analysis of FPEMP activities that contribute to such goal.

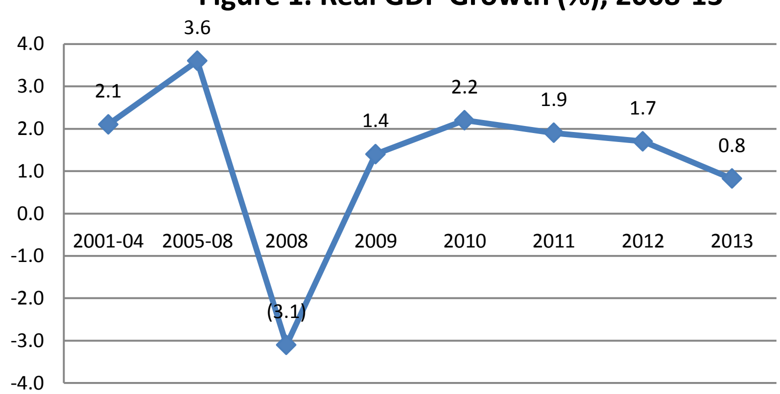
Continuing an FMLN-led government, president-elect Salvador Sánchez Cerén took office June 1, 2014. President Sanchez is continuing the partnership for growth (PFG) initiative with the U.S. government, which has generated positive expectations in the country. The FPEMP program supports important aspects in the fiscal area in the achievement of the objectives under the PFG, including tax revenue mobilization and greater efficiency of public spending. The new government has also shown commitment to a pro-growth reform agenda and to stronger public finances, which will positively impact the fiscal reform process already underway. Having ratified most of the high level directors and MOF officials, the change in government should not have disproportionate effects to the FPEMP activities.

The new government will be developing a new five-year plan for the period 2014 – 2019, where a clear strategy for achieving a more sustainable fiscal environment should be included. Additionally, El Salvador has committed in recent years to sturdy social spending such as health, education, employment and housing, particularly for the most vulnerable, that the new government is expected to preserve. A key aspect of the next administration will be the promotion of social dialogue and the fulfillment of important political agreements. The new set of revenue measures submitted for approval to the legislative assembly, as well as a plan to exercise public-spending restraint, will constitute important steps in a plan towards fiscal consolidation. Expectations of achieving a fiscal sustainability agreement (or "fiscal pact") have been renewed.

## Recent Economic and Fiscal Trends

El Salvador's economic performance after the 2008 financial crisis has been poor, as real GDP growth has not caught up to the growth rates experienced prior to the 2008 crisis. Performance of public finances has also deteriorated putting at risk macroeconomic stability. Despite important efforts and progress towards

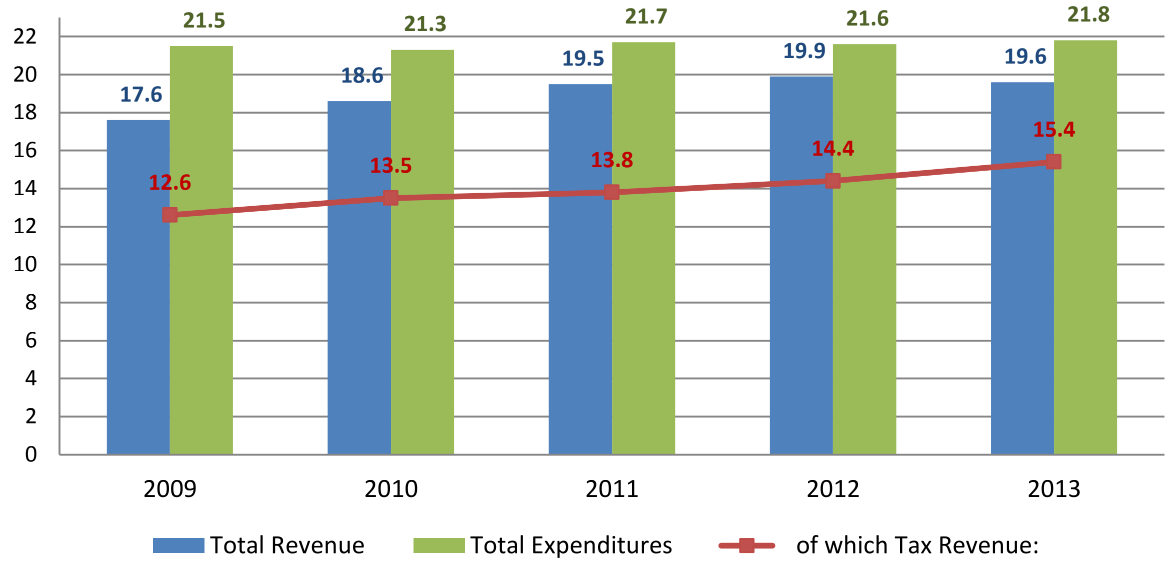
**Figure 1. Real GDP Growth (%), 2008-13**




[5] This chapter brings together economic outlook reports presented by the IMF mission report, Ministry of Finance data and analysis, as well as FUSADES's economic outlook report (April 2014).

mobilizing greater tax revenue, public spending has been increasing steadily, at a higher rate than the growth in revenues, generating a fiscal gap, on average, higher during 2010-2013 than before the 2009 crisis (currently at 3.9% of GDP). Furthermore, debt levels of the nonfinancial public sector has been growing since 2008 reaching 56.5 % of GDP in 2012, and not much different in 2013 at 55.3% of GDP.

**Figure 2. Total Revenues and Expenditures, 2009-13**
**(as % of GDP)**




The expansion of tax revenue collections in 2012 and 2013 was driven by the tax reform effective in 2012, in addition to significant improvements in tax administration in 2012 and 2013. Improvements in tax revenue collections in 2013 were achieved despite sluggish economic growth, as well as judgments of unconstitutionality of 3 different taxes (including the alternative minimum income tax of 1% on gross revenue) which negatively affected the further expansion of tax revenues in the same year. The GOES liquidity problems have intensified to the extent revenue forecasts continue to be optimistic. Although treasury operations have been optimized and consolidated into a single treasury account, the liquidity problem driven by inadequate budgeting practices, the GOES continues to issue short-term debt (*letes*) in order to meet government current spending.

The GOES should not continue a growing trend in spending and indebtedness without serious consequences. The current reform process in revenues, expenditures, fiscal transparency, and public financial management is accompanied by the formulation of a fiscal responsibility law, and considerations for achieving a fiscal sustainability agreement. The FPEMP program supports the GOES in all of these areas.

**Table 1 – Selected Economic and Fiscal Indicators, 2009-13**

| | 2009 | 2010 | 2011 | 2012 | 2013 | Average (2009-2013) |
|---|---|---|---|---|---|---|
| **Income and Prices** | | | | | | |
| Nominal GDP (Mill. US$) | 20,661.0 | 21,418.3 | 23,129.0 | 23,864.0 | 24,881.7 | |
| Real GDP growth | (3.1) | 1.4 | 2.2 | 1.9 | 1.7 | 0.8 |
| Consumer prices | 1.1 | 0.9 | 5.1 | 1.7 | 0.8 | 1.9 |
| GDP deflator | 130.8 | 236.0 | 249.4 | 252.0 | 252.4 | 224.1 |
| **External Sector** | | | | | | |
| Current account balance | (5.1) | (2.7) | (2.2) | (0.8) | N/A | (2.7) |
| Trade Balance | (16.0) | (17.0) | (19.0) | (18.0) | (20.0) | (18.0) |
| Foreign direct investment | 1.8 | 0.5 | 1.7 | 2.2 | 1.0 | 1.4 |
| **Non-Financial Public Sector** | | | | | | |
| Overall balance | (5.7) | (4.3) | (3.9) | (3.4) | (3.9) | (4.2) |
| Primary balance | (3.1) | (1.9) | (1.7) | (1.2) | (1.5) | (1.9) |
| Public sector debt [1/] | 50.0 | 51.5 | 51.6 | 56.5 | 55.3 | 53.0 |
| Total Revenue | 17.6 | 18.6 | 19.5 | 19.9 | 19.6 | 19.0 |
| of which Tax Revenue: | 12.6 | 13.5 | 13.8 | 14.4 | 15.4 | 13.9 |
| Total Expenditures | 21.5 | 21.3 | 21.7 | 21.6 | 21.8 | 21.6 |
| of which Current Spending | 18.4 | 18.1 | 18.8 | 18.3 | 18.6 | 18.4 |
| of which Capital Spending | 3.1 | 3.2 | 2.9 | 3.3 | 3.2 | 3.1 |

Sources: World Bank and Ministry of Finance of El Salvador.

1/ Includes external debt, internal debt and short-term debt of the central bank.

## USAID's support to the GOES on fiscal reform

The importance of strengthening the GOES' public finance system to guarantee sustained economic growth, to improve citizens' quality of life, while providing stability in the long term has gained recognition among the international donor community. USAID has been supporting the GOES in fiscal reform for many years, with very successful results.

USAID's Administrator Raj Shah said in the USAID/Economic Growth Officer's Conference of June 2010 that "many of the tax administration program that we support, [for example], the El Salvador Project, had been very successful and are a good return on investment." Supporting initially tax policy and tax administration reform, and most recently public expenditure management and citizen outreach through FPEMP, USAID has been highly recognized by the GOES counterparts and other donors for contributing to important improvements in tax revenue mobilization and public financial management.

USAID has provided extensive technical assistance on public finance during the post-civil war period. More recently, during the Tax Policy and Administration program which supported the GOES on tax policy and tax administration, the DGII made important improvements in collecting taxes more efficiently and effectively. The Tax Policy and Administration program supported tax policy reforms, the development of the tax administration IT system-JSIIT, the automatic tax control system-CSMS I, tax collection and taxpayer service call center, tax controls strengthening, tax administration functional reform, among others. The technical assistance provided through Tax Policy and Administration program helped the GOES increase tax collection by 47% between the periods of 2004 and 2008, and by 30% between 2010 and 2013 (excludes 2009 due to the financial crisis negative effects to the entire region). The General Director of DGII back in 2010 said about the project, "Tax Policy and Administration program assistance has been very important to DGII, as it has generated important structural changes allowing us to increase our tax collection and become a more effective tax administration."

Despite the significant advances made in tax collection during the Tax Policy and Administration program (tax collection increased from 12.2% of GDP in 2010 to 15.4% in 2013), the fiscal landscape of El Salvador shows a complex situation on the expenditure side, represented by a structural deficit generated by factors such as inappropriate budget formulation, undesirable budget execution control program, lack of a programmatic budget system, inefficient treasury financial management structure, absence of a TSA system and very poor procurement practices and lack of a fully transactional e-Procurement system, among others. On that regard, assistance through the FPEMP project has focused on three important objectives, component A provides assistance in the public expenditure modernization agenda; component B supports the tax administration modernization efforts, consolidating the advances made during Tax Policy and Administration program; and component C focuses on fiscal transparency and private sector outreach. The component A is by far the strongest component in the technical assistance provided by FPEMP.

USAID's assistance supporting the Salvadoran public expenditure modernization agenda seeks to provide the GOES with a sound public expenditure management, introduce sound budgeting practices based on results while promoting greater fiscal transparency. Bad public financial management practices over time have generated sustained fiscal deficits and growing debt levels. USAID through the FPEMP project supports the structural reform in this area, which includes a new budget system under a programmatic structure, a public accounting system under IPSAS, adoption of a TSA, an e-procurement system development, and development of a fully transactional SAFI II, developed with state-of-the-art technology. While a fiscal reform effort of this magnitude can be complex, all these short and long term measures should eventually contribute to improving the state of public finances in El Salvador, helping the GOES spend wisely, providing better services to the Salvadoran people and guaranteeing fiscal sustainability in the long term.

The GOES has demonstrated to be fully committed to implementing the fiscal reform agenda and a testimony to this assertion include the important advances and results quantified in this report. The detailed results contained in this report validate the GOES' advances made to date, with contribution by FPEMP (and other donors involved), recognizing the challenges involved in the reform process as well as the need to have continuous commitment from the GOES and the donors to ultimately accomplish sound fiscal policy and public financial management that contributes to achieving a stable macroeconomic environment.

# OBJECTIVE 1: ENHANCED PUBLIC EXPENDITURE MANAGEMENT

The GOES' MOF has embarked in a systematic, structural and gradual modernization of its public finances, in a commitment to achieve greater effectiveness and efficiency of revenue and expenditure management, as well as improving accountability and transparency in the public sector. While there has been an increasing growth trend in tax revenues and public expenditures, improvements in access and quality of public service delivery need to accompany such increases. The MOF attempts to bridge this gap through efforts to improve the budget process and various other aspects of public financial management to ultimately improve the quality of public services that Salvadorans expect and value. Additionally, the GOES has developed a proposal for a Fiscal Responsibility Law aiming to exert discipline and put limits on discretionary fiscal policy, leading to credibility in the management of public finances.

Technical assistance to the GOES from the various donors in this area has allowed the MOF to strategically plan the reform. The MOF's main objectives of the reform in this area include[6]: (1) improve the efficiency in the use of public resources, increasing access and financing services within a framework of fiscal sustainability; (2) improve the allocation of resources based on priorities and the country's development objectives; (3) transform the public budget in a management instrument leading to greater transparency and accountability; and (4) create the fiscal capacity to confront shocks derived from economic crisis and natural disasters.

FPEMP's technical assistance supports all of these objectives. The public expenditure management component focuses on modernizing the entire budget process (i.e. planning, execution, monitoring and evaluation), one that is driven by results, within a medium term framework and an upgraded platform of government financial management information system.

More specifically, the FPEMP program supports the GOES in adopting a new treasury management system including instituting a treasury single account; introducing government accounting practices in compliance with the international public sector accounting standards (IPSAS); strengthening and upgrading the government financial management information system (SAFI II) to conform to the new budget system; implementing a results-based budget system; upgrading the public procurement processes and procedures introducing a cutting-edge electronic platform for e-procurement; and improving fiscal transparency and accountability by publicly providing budget information that citizens need and want regarding public finances at the national and subnational levels (more on this as part of Component 3).

Assistance in the above-mentioned areas result from coordinated efforts among 8 different donors, including USAID, GIZ, EU, IDB, OTA, WB, IMF, AECID, and at least eight different departments at the MOF, led by the counterparts at DINAFI. During the first year of the FPEMP program a committee for donor coordination led by the DINAFI counterparts developed a reform strategy, the set of tasks and activities constituting the critical path to reform, thus avoiding

[6] "El Salvador's Public Budget Reform Plan." Ministry of Finance of El Salvador, November 2012. Available online at:
http://www.mh.gob.sv/portal/page/portal/PMH/Institucion/Marco_Institucional/Informes/Planes/Plan_de_Reforma_del_Sistema_de_Presupuesto_de_El%20Salvador.pdf

duplication of donor efforts while ensuring that every area of the reform is addressed. The distribution of tasks and activities resulted in FPEMP's reassignment of some areas of assistance and transferred to other donors. Such was the case for assistance in the upgrading of the SAFI, assistance to the MOF's UNAC, and the Human Resources Information System (SIRH). In the third year, however, assistance in these areas had to be reconsidered due to various challenges experienced by other donors supporting these areas. The FPEMP team, therefore, has had to step up, re-adapt, and commit to supporting the development of specific tasks in these areas by request of the Vice Minister of Finance. In this third year, therefore, this section includes a description of FPEMP's support to the development of the SAFI II as well as the development of the platform for e-procurement. Support to upgrading the SIRH is still under discussion and is expected to be part of FPEMP assistance to the GOES in the fourth year.

In reviewing the various areas of FPEMP assistance to the MOF in the third year, timely progress and important achievements have taken place in the areas of treasury operations, government accounting, development of the SAFI II, and e-procurement. Support to the DGP, however, for the implementation of a budget reform, entailing an administrative and functional modernization, and advancing towards the formulation of a programmatic budget has suffered notable delays. While the formulation of a programmatic budget was originally expected for fiscal year 2015, this has now been delayed to 2017. During the performance review, the MOF acknowledged the delays in this area and admitted full responsibility for such delays, which include among others, the counterpart delays in document approvals, delays in submitting input information, as well as lack of dedicated counterpart staff. Nevertheless, these challenges have already been discussed among the vice minister and the donors assisting in this area, and a steadier timeline and set of commitments from the counterparts constitutes a new plan for achieving important milestones in this budget reform area going forward.

Objective A's critical milestones achieved during FPEMP's third year of assistance:

- Treasury subsystem's 82 use cases completed and under review—basis for software development and integration into SAFI II.
- Government accounting subsystem's 5 out of 25 use cases completed—basis for software development and integration into SAFI II.
- Gained approval for using Costa Rica's Manual of Accounting policies and procedures as the basis for developing the Salvadoran Accounting Manual.
- Intervened to support software development in the GOES e-procurement system implementation, reinstating continuity of activities, while fulfilling delivery timeliness through the use of "extreme programming" methodology.
- Identified important issues/challenges in the budget execution programming (PEP—*Programación de la Ejecución Presupuestaria*) methodology, which carries important legal and operational implications in the budget process. Developed a proposal for the PEP's Modification, currently under review.

Objective A's key quantitative results achieved during FPEMP's third year of assistance:

- ✓ 22 of 25 government institutions already operating under a treasury single account.
- ✓ Consolidated into the treasury single account the approximately 1,600 bank accounts with idle balances totaling $25 million monthly.
- ✓ Achieved integration of 96 percent of the 11 different commercial banking institutions (the treasury's payment agents) with the Central Bank and TSA system.

- ✓ GOES payment transactions reduced from 10 days to 2-3 hours.
- ✓ Completed the GOES' new Chart of Accounts containing over 6,000 accounts and subaccounts, up from 1,000 previously, developed in compliance with international public sector accounting standards.
- ✓ Accomplished software development of 1 out of 5 modules of the new e-procurement system COMPRASAL II, the Annual Procurement Plan module (PAAC—*Plan Anual de Adquisiciones y Compras*), facilitating greater transparency and efficiency in the public procurement process.

## Advancing the Implementation of a treasury single account

The MOF has achieved much progress in the implementation of a TSA. The DGT has benefitted from FPEMP's assistance since 2011 for the implementation of a TSA. Many of the tasks involved in improving treasury operations have already been achieved; others are still in progress, while others are still pending for the fourth year of assistance.

**Table 2 – Status of activities related to implementing a TSA**

| | |
|---|---|
| Assessment and recommendations for the TSA implementation | Completed |
| Development of the TSA conceptual model* | Completed |
| Seminars on TSA | Completed |
| Study tour to Argentina to learn about the Argentinian TSA | Completed |
| IT procurement for the DGT | Completed |
| Implementation of the TSA in 25 GOES entities | In Progress |
| Training program on use cases design to DINAFI, DGP, DGCG, and DGT | Completed |
| SAFI II treasury subsystem use cases design | Completed |
| SAFI II treasury subsystem software development | Pending |

* *Conceptual model contains the following: (1) financial planning, including financial programming and budget execution (appropriation, funds allocation, commitment); (2) treasury operations (collections and payments); (3) cash management (account management and reconciliation of transactions); (4) custody of funds and Securities.*

Before the TSA implementation in El Salvador, an assessment of the treasury operations found that the cash management function of the DGT was leading to inefficient management of cash flows, where over 1,600 bank accounts with idle of balances of approximately $25 million monthly needed consolidation. Tight cash flows contribute to the issuance of short-term treasury bills in order to meet the GOES payment obligations, representing $17.35 in cost of *letes* in 2012. While idle balances have been eliminated by consolidating balances into the TSA and cash management operations have improved, other factors (i.e. rising fiscal deficit and improper budget execution programming practices) are contributing to the still rising cost of *letes*, which represented $32.25 million in 2013 and approximately $15 million for the first half of 2014.

Some of the issues identified by the FPEMP team which also contribute to the increasing need to borrow short-term through *letes* include: (1) budget planning/formulation based on gross revenue rather than net revenues which overestimates the funds available to the government; and (2) lack of quarterly/monthly commitment targets with regard to budget execution, which impose a ceiling on the amount of payment orders that may be registered by the GOES entities allowing a proper system of commitment control. More details on these issues, which have important legal implications, are presented in the section. These issues have been brought forward to high level officials of the MOF, and the FPEMP team expects to support the legal reform of these improper budgeting practices working towards achieving fiscal discipline in this area by 2017.

The TSA conceptual model presents a detailed guide on processes, sub-processes and procedures; information and reporting system; and integration with other subsystems, including budgeting, accounting, tax collection, investment and public credit. The main processes presented in the conceptual model are the result of a redesign of the subsystem of treasury operations. Based on this conceptual model, in the third year, all bank accounts with idle balances had been consolidated. Additionally, 90 percent of banks had integrated their systems with the Central Bank, and with the DGT. Furthermore, the TSA was rolled out to an additional 19 entities, reaching 22 entities operating under the TSA at the end of the FPEMP's third year. There are 3 more entities left to be integrated, expected by the end of June 2014,: Institute for Access to Public Information, Court of Audit (Corte de Cuentas), and the Ministry of Justice and Public Safety.

**On FPEMP's quality and collaborative assistance**

*"The MOF is highly satisfied with the FPEMP program assistance. The team is always more willing to meet our needs with high quality and great collaboration. Among the assistance received, FPEMP's provides the highest value!."*

- Roberto J. Solorzano
Vice-Minister, MOF El Salvador
May 2014

Additionally, during the third year, FPEMP supported the design of the treasury subsystem's 82 use cases, which are basis for the software program development and integration of the treasury's payment system into the SAFI II. Such use cases have been design in the basis of the conceptual model. In software development, a use case provides the list of steps that define interactions of processes and sub-processes within a system and these are key input for software development.[7] While all use cases of the treasury subsystem have been completed, at the time of this writing, such use cases were still pending review and approval before proceeding to software development.

Moving forward, one important challenge in advancing the modernization of the treasury function becomes the overlaps with the financial planning and budget execution activities. Delays and issues found in the design of the budget formulation module by the DGP affect the design of the budget functions of the treasury, including: financial planning (revenue and expenditure forecasts) and budget execution (appropriations, funds allocations, commitment controls). While the GIZ, had supported the MOF in designing the budget formulation sub-system, FPEMP assistance is now also supporting tackling such remaining issues in budget formulation while also supporting development of the budget execution module.

Particularly, it is expected that budget formulation will take into account forecasts presented in the medium term forecasts and budget execution would follow financial availability in the cash budget. Achieving this requires the DGP to set quarterly commitment targets with regard to their execution proposals. The DGT will then set monthly quotas for payments, established on the basis of quarterly commitment targets. These quotas would impose a ceiling for the amount of

[7] In the first year of the program, the GOES through assistance from the World Bank made an assessment of the government financial management information system upgrade (SAFI II). The options included purchasing a commercial-off-the-shelf solution versus custom development. The latter option was selected and the FPEMP program has been supporting such custom development since.

payment orders that may be registered by the GOES entities, thus allowing a proper system of commitment control.

In the fourth year, FPEMP assistance in the treasury function will focus on solving the overlapping issues of the budget process and its overlaps with the treasury function, as well as software development of the treasury subsystem for integration into the SAFI II. While the treasury functions to be interfaced with the SAFI include the payment systems, the integration of the revenue system (SITEP) into the SAFI II is out of the scope of FPEMP assistance. As part of FPEMP experts' analysis of the scope of SITEP and its components (including *letes* collections and other services), it is recommended that the counterparts assess its integration with the SAFI II when the MOF sees fit.[8]

## Modernizing Public Expenditure and Financial Management in El Salvador

FPEMP's assistance in this area focuses on supporting the MOF to attain efficient and effective public expenditure management through a modernized public budget process that is multi-year and based on results. Additionally, FPEMP supports the modernization of the GOES's public financial management information system through the implementation of the new SAFI II.

In the first two years of assistance, FPEMP provided fundamental input to the development of the proposal for reforming the budget and financial management system, which has become the foundation for the modernization of the entire budget process as well as the SAFI II. Additionally, FPEMP supported the development of a model for the functional and administrative reform of the DGP as well as the design of use cases for the budget formulation module of the SAFI II.

FPEMP's assistance in this area supports mainly the DGP and DINAFI, but also supports other agencies involved in the budgeting process. FPEMP assistance in the third year constitutes follow-on activities to other donors such as the GIZ and the EU. In many instances, activities that other donors support, pave the way for activities that FPEMP is scheduled to perform and some delays in the completion of these preceding have affected FPEMP's support activities.[9] An initial reform plan projected that the first programmatic budget would be formulated for fiscal year 2015. However, challenges have caused delays, and the expectation is to achieve the first programmatic budget for fiscal year 2017.

Adoption of budgetary reforms can be complex and timeliness in the reform plan requires the government's commitment for reform, strong leadership, and dedicated counterparts that can move the reform process onward. The FPEMP team encountered some challenges in supporting the reform process, facing particular hurdles and weaknesses in the above-mentioned requirements for timely reform. Through discussions with MOF's high level officials during this performance evaluation, the GOES has assured their continued commitment towards the budgetary reform, admitting full responsibility for delays in this area, and guaranteeing that going forward the MOF will tackle the challenges and hurdles affecting FPEMP assistance activities, particularly those related with the DGP.

[8] See FPEMP technical report on "Modelado de Casos de Uso del Subsistema de Tesorería," March 2014.
[9] The GIZ assists the GOES to develop the conceptual model of the budget modernization Project, the medium term expenditure framework, the programmatic Budget and the institutional expenditure framework methodologies and manuals.

The FPEMP team has put together a detailed schedule of activities for supporting the DGP, including specific deadlines for submitting deliverables, as well as strict deadlines for counterpart's approvals, all of which are important in supporting the MOF's timely progress with the reform. As FPEMP enters the fourth and last year of assistance in June 2014, it is now evident that the goal of achieving a programmatic budget would require additional time, beyond the contractual timing of FPEMP assistance.

The table below provides an overview of activities that have been completed, in progress or pending, in the FPEMP's areas of assistance related to budgetary reform and implementation of the SAFI II. Following is a more specific description of FPEMP activities in support of the budgetary reform and the implementation of the SAFI II.

**Table 3 – Status of activities related to budgetary reform and SAFI II**

| | |
|---|---|
| Development of proposal for reforming the budget and financial management system | Completed |
| Development of DGP functional administrative reform proposal | Completed |
| Support the DGP functional administrative reform implementation | In Progress |
| Study tour to Colombia to learn about GRP systems | Completed |
| IT procurement for the DGP | Completed |
| Study tour to Argentina to learn about budget M&E, budget programs formulation and result oriented budget | Completed |
| Design of budget programs based on a results oriented approach for 3 Ministries (Health, Agriculture and Economy) | Pending |
| Strengthening of the DGP's M&E Unit capacities | Pending |
| SAFI II budget formulation module use cases design | Completed |
| SAFI II budget formulation module code generation | Pending |
| SAFI II budget execution module use cases design | In Progress |
| SAFI II budget execution module code generation | Pending |

**The Budget Modernization Project**

FPEMP's assistance in the budget modernization consists on supporting: the DGP's functional and administrative reform; the implementation of a programmatic budget that focuses on results in 3 pilot ministries (Health, Agriculture and Economy); and enrichment of capacities of the DGP's monitoring and evaluation of budget performance.

While the DGP has already endorsed the proposal document for the functional and organization reform of the DGP, the implementation plan is still in progress. The FPEMP team has experienced delays in the DGP's review and approval of related documents, causing delays. Based on the new schedule of commitments with the DGP, activities in this area are expected to move forward in the 4th year. However, given delays in related areas of budget formulation and budget execution, delays could still happen which put at risk completion of this task during the fourth year of FPEMP assistance.

Support to the GOES' achievement of a programmatic budget is coordinated with other donors including the GIZ. Delays in preceding activities have also caused delays in initiating activities at the 3 pilot ministries assigned to the FPEMP team, which include Health, Agriculture and

Economy. Delays in this area include the permanent changes in the SAFI II implementation schedule, before FPEMP was asked to support the development of the system. Now that the FPEMP program is supporting the GOES in this area, work is on schedule and milestones are being met. Activities in this area of results based budgeting are expected to begin in October 2014.

## Implementation of the SAFI II

The FPEMP team supports the implementation of the SAFI II by supporting the system requirement (use cases) development for the budget execution module, the treasury subsystem and the public accounting subsystem. FPEMP will also support the full software development of the treasury subsystem and the code generation for the budget formulation and the public accounting subsystem. The FPEMP team supports the MOF's DINAFI in the implementation of the SAFI II, after the GOES (jointly with the World Bank) decided to follow a custom-built system approach rather than purchasing and customizing a commercial-off-the-shelf system.

In the SAFI II implementation process, since the third year, the FPEMP team supports the "Code Generation" process of the new software engineering development—a key component in software development, representing the implementation platform for developing the different modules. Code generation is an important aspect in software engineering. The purpose of Code Generation is to create an implementation platform to ease transitions in software solutions development. It also helps improve productivity, quality of the application development due to standardized implementation and increases performance of the application using generators that produce efficient coding.

In addition to Code Generation, FPEMP supports the development of the budget formulation and budget execution modules of the SAFI II. Initially, the FPEMP team was tasked with supporting the DINAFI in developing terms of references for contracting information technology services for the procurement of an off-of-the-shelf system for SAFI II, financed through a World Bank loan. However, the MOF requested the FPEMP team to intervene in directly contributing to the budget formulation and budget execution module development in addition to the Code Generation task after the GOES faced issues with the use of World Bank funds.

As such, the FPEMP team, through the COP's leadership, has been flexible, adaptable and responsive to the MOF's requests in such complex task of developing the new SAFI II (as well as the development of the COMPRASAL II)[10], by adjusting their activities to include the MOF's requests without jeopardizing assistance in other areas requiring software development skills such as the CSMS development.

**On FPEMP's flexibility and responsiveness**

*"We have received highly diligent assistance from FPEMP, even in tasks that were outside their scope of assistance. The COP is results-driven and a problem solver who has helped us rescue the reform process".*

- Dinora Cubias
Director, DINAFI El Salvador
May 2014

## Challenges facing budgeting practices in El Salvador

[10] The MOF through support from the IDB is advancing its public procurement system, including the enhancing of the e-procurement system by introducing the COMPRASAL II. Due to unavailability of qualified programmers, the MOF also requested the FPEMP team to intervene in supporting the UNAC in developing modules related to the new COMPRASAL II. These are currently underway.

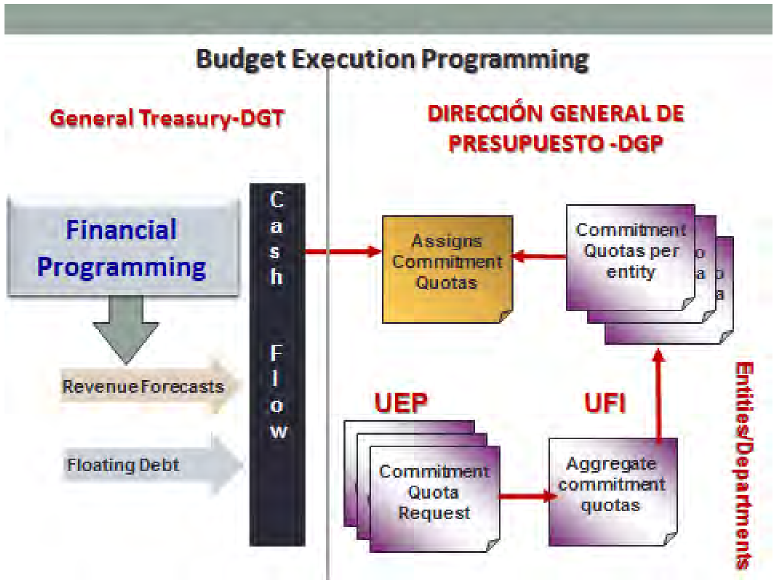
In supporting the MOF for designing the budget execution use cases, the FPEMP budget experts started by the process on the basis of the legal framework, the budget formulation use cases, the conceptual model of the new budget system and the medium term (fiscal, expenditure and institutional) frameworks. These last two, the MOF developed with assistance from GIZ and the IMF, respectively.  The program found out that the conceptual model of the budget system did not have the budget execution conceptual model for the new programmatic budget system, in that regard FPEMP developed the conceptual model for the budget execution before proceeding to the use case development. Findings of the analysis of the GOES' budgeting practices for the purpose of developing the budget execution module, gave rise to important issues and challenges requiring modifications to specific aspects of the budgeting process before further proceeding with use case design. These issues also affect the budget formulation module the MOF produced with assistance from the GIZ, while also affecting processes involving the Treasury. All of these have caused some activities to stay pending resolution to these issues.

While this performance review was taking place, the FPEMP team had submitted a document to the MOF with a proposal for modifications that need to take place in order to ensure that budgeting practices are in accordance to the constitution and the legal basis (*Ley AFI*), as well as the best international practices. One main budgeting issues/challenge is related to the programming of budget execution, as follows:

- **Budget Execution Programming (*Programación de la Ejecución Presupuestaria*—PEP):** This is the step before budget execution and after budget formulation. The formulation and execution of the budget are currently prepared on a separate basis. In order to initiate budget execution, a copy of the budget is loaded into the Oracle database. The PEP then consists of a distribution of funds on the approved budget which records estimated amounts accrued for each month of the fiscal year. This PEP once distributed replaces the approved budget and most of the changes are made to the PEP through reprogramming. However, the PEP does not guarantee the balance between what the GOES collects and what is spent, which is required by law (art. 226 of the Constitution and Art. 27 AFI Law).

  In the new SAFI II, the budget execution programming is expected to follow the legal basis and the international best practices, linking budget formulation (revenue and expenditure forecasts) with the Treasury's cash flow and finally with the DGP's assignments of commitment quotas per entity. The Budget execution units then put forth requests to the DGP for program spending. This process then ensures there is a balance between funds available and program spending.

**Figure 3. PEP in the new SAFI II**




- **Other budgetary issues:** There are other issues including the multiplicity of budgets currently being formulated including 9 different types (General Budget, extraordinary budget, special budget, special activities fund, extraordinary institutional budget, municipal budget, special extraordinary like FOMILENIO, special extraordinary for social investment, extraordinary for electoral events) when the legal basis supports only three types. Additionally, in the execution of revenues, there are some fees that entities are raising which are not submitted to the general budget as "nontax" revenue or "other" revenue, but these are assigned to be directly spent by the collecting agency disregarding general budget approvals.

During this performance review, it is our understanding that the FPEMP team is in the process of submitting to the Vice Minister of Finance and the DGP a proposal of budgetary modifications that need to take place before moving forward with the reform plan activities. These issues—sometimes requiring a legislative decree or DGP's authorization in other instances—are expected to be resolved by July 2014, in order to proceed with the development of the budget formulation module development as well as the budget execution use cases.

## Adopting IPSAS

FPEMP's assistance to the DGCG began since the first year of the program. Activities in this area have advanced in a collaborate manner with the government counterparts, working with a dedicated working group of 13 officials from the DGCG, ensuring timely, effective progress in the modernization of the government accounting system, leading towards full adoption of the IPSAS, expected to be completed by 2020.

In the first years of assistance, FPEMP supported the MOF providing a detailed assessment of the government accounting practices and developing recommendations for adopting IPSAS. The FPEMP team provided the required sensitization and capacity building to directors and other officials related to government accounting practices and IPSAS. Additionally, FPEMP financed a study tour to Peru expose Salvadoran officials to international best practices in the region in adopting IPSAS. Through a study tour to Costa Rica, and with collaboration of FPEMP experts, the governments of El Salvador and Costa Rica signed a memorandum of understanding allowing the GOES the use of Costa Rica's government accounting policy manual as the basis for developing the GOES' own.

**Table 4 – Status of activities related to government accounting modernization**

| | |
|---|---|
| Assessment and recommendations for the IPSAS adoption | Completed |
| Training on IPSAS to MOF Directors | Completed |
| Training on IPSAS to DGCG | Completed |
| Study tour to Peru to learn about IPSAS adoption | Completed |
| Training on financial instruments under IPSAS | Completed |
| IT procurement for DGCG | Completed |
| Study tour to Costa Rica to learn about IPSAS adoption | Completed |
| Development of new Chart of Accounts in accord with IPSAS | Completed |
| Government accounting sub-system use cases design | In progress |
| Government accounting sub-system module code generation | Pending |
| Support the development of the accounting policy manual | Pending |

In the third year of FPEMP assistance, the GOES achieved the development of a new chart of accounts in accordance with the IPSAS, thus increasing the number of accounts and sub-accounts from 1,000 to over 6,000. Once implemented, the new chart of accounts supports greater detail in government budgetary operations supporting better informed assessments of resource allocation, as well as greater transparency and accountability. This greater detail in the GOES accounts will serve as input to the newly enhanced MOF's Transparency Portal, increasing the amount and quality of information made available to the public.

Additionally, the new enhanced chart of accounts and accounting sub-system requires registering of all transactions, minimizing chances for manipulating procurement processes, also allowing detection of unethical processes. The accounting process is considered to be the basis of all budgetary processes, linking all other sub-systems including treasury operations, budget formulation and execution, and public procurement.

In the next year, FPEMP's assistance in this area includes the design of the government accounting 40 use cases (5 already completed by the end of the third year), which are currently in progress. Additionally, FPEMP will support the DGCG's development of the accounting policy manual, including 32 rules and policies for government accounting. Additionally, integration the government accounting sub-system into the SAFII cannot take place until all other sub-systems have been developed, including the budget, treasury, and procurement.

Adoption of IPSAS is not an easy task and it will take few more years to achieve, expected to begin in 2017 and to end in 2020. Implementing IPSAS will require broad sensitization and capacity building of the GOES' 118 entities of the public sector, 262 municipalities and 20 associations of municipalities (*mancomunidades*).[11] FPEMP supports the DGCG through the process of IPSAS implementation, however full implementation is expected to take place beyond

[11] FPEMP's assistance in the modernization of government accounting excludes a module for the GOES' asset management, which is key component currently managed outside of the DGC in El Salvador. Developing this module would require the GOES' consideration for reforming asset management.

the contractual timing of the program. Technical assistance is recommended throughout the process to ensure successful IPSAS implementation.

## Enhancing the e-procurement system, COMPRASAL II

During the first year of assistance, and due to the donor coordination activities, assistance to the UNAC and the implementation of an upgraded e-procurement system, COMPRASAL II was assigned to the IDB. However, in the third year of FPEMP's assistance, the MOF requested FPEMP's assistance due to various challenges faced by the counterparts, including the inability to hire and retain qualified software programmers that could move forward to implementation of the new COMPRASAL II. Avoiding a stall in the implementation of the COMPRASAL II, FPEMP stepped up to assist the UNAC with this task.

The current COMPRASAL I is an information tool containing statistical data, and also serving as a portal where the 384 public institutions publish their acquisition requests. However, this is not a transactional system. The GOES' new generation of e-procurement, the COMPRASAL II, will support a registry of providers, facilitating validation of their information, at the same time disallowing multiple provider registries. Additionally, the COMPRASAL II will allow the upload of the GOES' PAAC, which will be linked to the financial programming of the budget. This electronic platform additionally will sustain an approval process of the GOES' entities' acquisition catalogs.

The COMPRASAL II supports the following procurement modules:

1. PAAC
2. *Libre Gestion* (smaller purchases below threshold not requiring tendering)
3. *Licitaciones* (tendering process)
4. *Concursos publicos* (competitive tenders)
5. *Administracion de contratos* (contract management)

Joining the IDB's technical assistance, in the third year, FPEMP's programmers assisted the UNAC with developing 1 out of 5 modules of the COMPRASAL II, the PAAC. FPEMP supported software development of the PAAC, reinstating continuity of activities, while fulfilling delivery timeliness through the use of "extreme programming" methodology, achieving agile software development with the practice of pair programming in short development cycles. The PAAC is scheduled to begin implementation through training and capacity building in June 2014. The PAAC 2015 is expected to be implemented via the COMPRASAL II.

Additionally, FPEMP supported a study tour to Panama and Colombia to expose Salvadoran officials to the IQC and reverse auction mechanisms of procurement, allowing the integration of such mechanisms into the new public procurement design. Furthermore, FPEMP supports the UNAC' functional and administrative strengthening as well as capacity building and training.

**Table 5 –Status of activities related to implanting e-procurement, COMPRASAL II**

| | |
|---|---|
| Study tour to Panama and Colombia to learn about IQC procurement and reverse auction | Completed |
| COMPRASAL II's design, phase II development | In Progress |
| Support the UNAC administrative strengthening | In Progress |
| Support the e-procurement system (COMPRASAL) II phase I development | In Progress |
| Support the e-procurement system (COMPRASAL) II phase II development | Pending |

There is an average of 9,020 vendors providing goods and services to the GOES on an annual basis. The expected benefits of the COMPRASAL II include: greater automation of processes, efficiency gains through reductions in transaction costs, greater transparency in the procurement process, and greater accountability through the availability of information facilitating social audits.

In the next year, FPEMP is expected to continue assistance to the UNAC in developing the COMPRASAL II, while also supporting the administrative strengthening, and the software development of the remaining four modules for the COMPRASAL II. As FPEMP enters the fourth and final year of assistance, the UNAC will require additional assistance to ensure full implementation of the COMPRASAL II.

## Challenges ahead for implementing public expenditure management activities

- DGP-related activities for the implementation of a modernized budget and financial management system have suffered significant delays. The formulation of a programmatic budget has been postponed from 2015 to 2017. The FPEMP has reached out to the MOF's Vice Minister of Finance for supporting a detailed schedule of activities with strict deadlines for DGP's reviews and approvals. Additionally, FPEMP has requested that the DGP strengthen their counterpart team's personnel for supporting the timely implementation of the reform.
- Findings of the analysis of the GOES' budgeting practices for the purpose of developing the budget execution module, gave rise to important issues and challenges requiring modifications to specific aspects of the budgeting process before further proceeding with use case development. These issues also affect the budget formulation module the MOF produced with assistance from the GIZ, while also affecting processes involving the Treasury. All of these have caused some activities to stay pending resolution to these issues.
- Retaining a team of skilled programmers who currently support FPEMP's assistance to the MOF in software development for activities related to the SAFI II, including the treasury, government accounting, budget, and COMPRASAL II subsystems. These programmers also support the development of the CSMS II.
- While the treasury functions to be interfaced with the SAFI II include the payment systems, the integration of the revenue system SITEP into the SAFI II is out of the scope of FPEMP assistance. As part of FPEMP experts' analysis of the scope of SITEP and its components (including *letes* collections and other services), it is recommended that the counterparts assess its integration with the SAFI II when the MOF sees fit.
- Integrating the government accounting sub-system into the SAFII cannot take place until all other sub-systems have been developed, including the budget, treasury, and public procurement. Any delays in developing the other sub-systems could impact the completion of the SAFI II implementation.
- Adoption of IPSAS is expected to begin in 2017 and to end in 2020. Implementing IPSAS will require broad sensitization and capacity building of the GOES' 118 entities of the public sector, 262 municipalities and 20 associations of municipalities. FPEMP supports the DGCG through the process of IPSAS implementation, however full implementation is expected to

take place beyond the contractual timing of the program. Technical assistance is recommended throughout the process to ensure successful IPSAS implementation.

- Through FPEMP assistance has been timely and effective, delays and challenges faced by the GOES counterparts, as well as some delays due to the electoral calendar have affected the schedule of FEPMP assistance activities. The comprehensive fiscal reform process that El Salvador's MOF envisions requires continuing technical assistance and donor support. As challenges remain regarding completion and closing of other donor projects, as well as issues regarding the use of World Bank funds to finance technical assistance, the MOF will increasingly rely on USAID's technical assistance to rescue the reform process. FPEMP has already had to intervene in the third year to rescue important activities, such as the implementation of the e-procurement system and software development of the SAFI II.

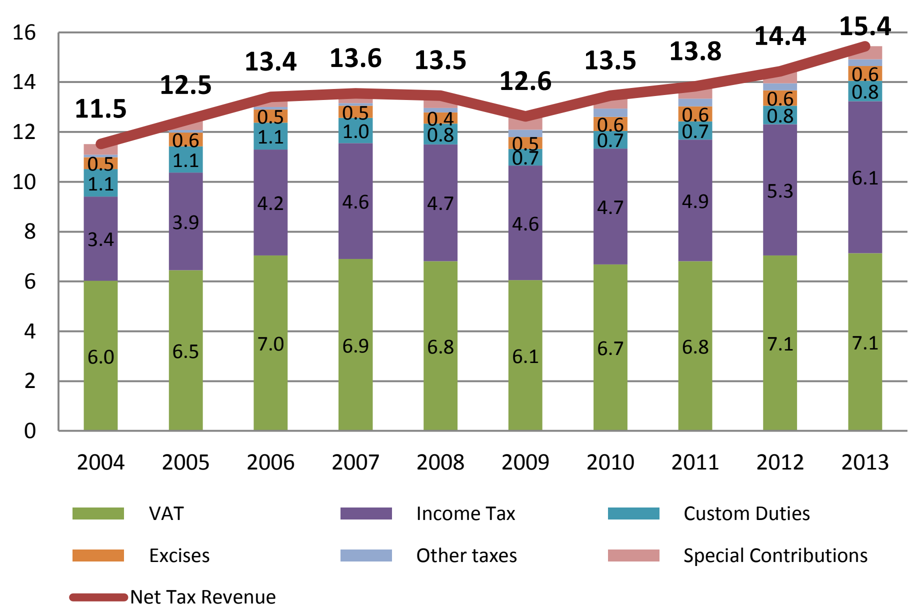
# OBJECTIVE 2: IMPROVED REVENUE MOBILIZATION

El Salvador has achieved important progress in mobilizing greater tax revenue in the past decade. Tax revenue has increased from 11.5 percent of GDP in 2004 to 15.4 percent in 2012—nearly a 4 percentage point increase—overcoming the effects of the global financial crisis and achieving a consistent growth trend since 2010. Since USAID assistance in the area of tax policy and tax administration, initiated through TPAR in 2005 and continuing with FPEMP in 2011,

Taxes from the value added tax continue to be the largest component of tax revenue representing nearly half of collections, however, taxes from income and profits have been consistently increasing growing by nearly 25 percent since 2011 with the introduction of a fiscal reform package in 2012. While there was an increase of 0.6 percentage points in tax-to-GDP in 2012 when the tax reform was implemented, in 2013—two years after the tax reform—the DGII experienced the highest increase in tax collections since the 2004 tax reform collecting an additional 1 percent of tax to GDP. Although the DGII does not have a microsimulation model that can more accurately inform gains in tax revenue due to the changes in tax provisions, this evaluation can attribute at least $26.2 million directly mobilized by the new CSMS II through the fiscal compliance, fiscal audit modules, and treasury call center.

Tax collections in 2013 surpassed those in 2012 by $71 million, that is, 37% of the additional revenue collected. The CSMS II currently supports the control, traceability, and workflows of approximately $97.3 million of revenue collected in 2013. The GOES expects to further improve tax revenue performance to invest in priority spending while also improving public expenditure management.

**Figure 4. Tax (Net) Revenue Collections, El Salvador 2004-2013 (as % of GDP)**




*Source: General Directorate for Internal Revenue (DGII), El Salvador.*

Tax revenue in 2013 grew despite the revoking of the alternative minimum tax (AMT) of 1% on gross income, established in the articles 76-81 of the Income Tax Law. The AMT statutory scheme was declared unconstitutional by the Supreme Court of Justice on 15 November 2013, on the grounds that it violated the constitutional principles of tax fairness and ability-to-pay by not allowing taxpayers to take any deductions on costs and expenses necessary to generate taxable income or to protect the source thereof.[12]

By the end of 2013, authorities had developed a tax reform bill estimated to mobilize $150 million. The tax reform package—which legislators voted no in May 2014—proposed to tax bank transfers (on financial transactions above $750), luxury homes (worth above 250 thousand, in urban areas, taxed at 10%), as well as removal of tax exemptions benefiting printing companies. At the time of writing, the GOES had agreed to modify the terms to take into account criticisms made by the private sector. With a new government sworn in at the beginning of June 2014, the authorities envisage that a fiscal pact may move forward, containing measures to mobilize tax revenue to support key social programs.

USAID's assistance since 2005 through the predecessor project Tax Policy and Administration Reform and the FPEMP has been vital in supporting the GOES's tax revenue mobilization achievements. In the first two years of assistance, the FPEMP supported the DGII to implement the Treasury's Collections Call Center for tackling tax arrears; redefining the Large Taxpayer's Office from 1,500 to 639 largest taxpayers and improving their services; improving taxpayer services to medium and small taxpayers; cleaning and updating of the TCA; cleaning and updating of the TRS; and supporting rigorous and fair audits through the enhancement of the CSMS.

FPEMP's assistance in the third year focuses on concluding the cleaning of the taxpayer registry and current account while supporting the institutionalization of a permanent unit for avoiding the constant polluting of these; implementation of the CSMS while supporting the implementation of the fiscal reform package of 2012, tax enforcement and other key tax administration processes. Such tasks involved achieving critical milestones during FPEMP's third year:

- Finalized the cleansing of the TRS and TCA.
- Institutionalization of a permanent unit within the DGII tasked with the cleansing of the TRS and TCA on an ongoing basis since February 2014.

Key quantitative results achieved during FPEMP's third year of assistance:

- Tax (net) revenue collections augmented by 30 percent since 2010, from 13.5 percent in 2010 to 15.4 percent in 2013, that is just about a two percentage point increase relative to GDP in the first three years of the program.
- The Treasury's Collections Call Center mobilized approximately $3 million in additional tax revenue from tax arrears and income tax resolutions, in the first 9 months of operations. Additional half a million in tax revenue has been collected in the last year.

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[12] See Supreme Court's resolution at http://www.google.com/url?sa=t&rct=j&q=&esrc=s&frm=1&source=web&cd=1&ved=0CB0QFjAA&url=http%3A%2F%2Famayapinedayasociados.com%2Fdescargas.html%3Fdownload%3D11%253Ainconstitucional1delimpuesto&ei=sqe3U-CwJNOKqgbh24CACA&usg=AFQjCNFBrQFcXqm1Ar_QNxRJau5jEUq1oA

- By October 2013, the TCA Cleaning Project completed the cleansing of 21,523 records, of which 273 were large taxpayers, completing 100 percent of the total records needing verification.
- By the end of 2013, the TRS Cleaning Project completed the cleansing of 7,730 records, while replacing TIN cards of all the same taxpayers, eliminating 610 cases of duplicity.
- Nearly $2 million additional tax revenue identified and collected by the LTO' transfer pricing unit in 2013-14.
- The fiscal compliance module of the CSMS II, in 2013, allowed the contacting of 19 thousand taxpayers with inconsistent records (including 6,228 collection email notices in less than 12 hours, 8,931 collection letters in less than 3 days, 2,022 collection calls), helping produce an additional $1.2 million in additional tax revenue (more than US$131,000 from small taxpayers and over US$700,000 in income tax collected during the first 3 days).
- During tax season in 2014, the fiscal compliance and the newly functioning audit modules of the CSMS II, allowed the contacting of over 27 thousand income taxpayers through a preventive campaign using suggested tax declarations (including 17,209 salaried employees with tax liabilities greater than $3, and 10,020 legal persons and personal income taxpayers with diverse income), helping boost tax revenues by $12.4 million.
- Massive tax audit cases processed through the CSMS II generated $2.6 million in additional revenue in 2013, and $2.1 million in the first 4 months of 2014.
- Through the CSMS II, the portfolio management unit ("*gestion de cartera*") has reduced the amount of cases processed in the field from 70% to 30%, thus reducing administrative costs, improving targeting and productivity.
- In the past various errors were found in the calculation of amounts withheld by retention agents from salaried employees—most of which applied as definitive tax payments—generally lesser amounts than what should have been withheld. The CSMS II has facilitated more accurate calculation of tax withholdings, producing $10.7 million in additional tax withholdings and therefore in additional tax revenue.
- The CSMS II facilitated the reduction of 265,746 tax refund transactions from 2012 to 2013. The DGII estimates that each transaction costs $5.65 to process; that is a $1.5 million in administrative cost savings.

## Tackling Tax Arrears through the Treasury's Collections Call Center

As in many countries around the world, uncollected tax arrears meant a great challenge for the GOES' tax administration, accumulating at a rate of $15-20 million per year. Following the success of the Call Center at the DGII—created with USAID's assistance through TPAR—FPEMP supported the DGT to set up a Collections Call Center which became fully operational in August 2012. After only 9 months of operation—from August 2012 through May 2013—the DGT Call Center had collected over $3 million in additional tax revenue from the largest collectible tax arrears and income tax resolutions.

Three technicians led by a Collections Supervisor make up the DGT's Collections Call Center. During the first ten months of operation the Call Center initiated 18,384 calls and collected over $1 million from tax arrears, surpassing the collections' goal for the year. Furthermore, the Call Center collected approximately US$1.5 million from income tax resolutions for tax year 2011. In the last year, the Call Center collected approximately another half million dollars in tax revenue.

With only three officers, DGT's Collections Call Center surpassed the amounts collected by the Attorney General's office in one year, which employs a staff of more than 45 attorneys.

**Table 6 – DGT's Collections Call Center Performance (August 2012 – May 2013)**

| | DGT' s Call Center | | Income Tax Resolutions 2011 | | |
|---|---|---|---|---|---|
| | **# of Calls** | **Amount Collected** | **# of Resolutions** | **Collectable Amounts (Taxes + interest)** | **Amount Collected** |
| Aug 2012 – May 2013 | 18,384 | $1,019,572 | 7,673 | $28,800713 | ~ $1,5 million |
| June 2013 – May 2014 | 36,645 | 490,190 | N/A | N/A | N/A |
| Total | 55,029 | **1,509,762** | | | 1.5 million |

Source: DGT

The Call Center's calls have led to: (1) taxpayers' visit to the DGT in response to the initial call, allowing a formal notification of collections; and (2) most visits result in payment in full or partial payment of amount owed. Previously, officers would collect tax due by physically visiting the taxpayers address on record. These visits meant that the officer had to leave the office and travel to the location, exposing themselves to risks of theft and crime in the country, becoming victims in many instances. The Collections Call Center has not only reduced/replaced the need to physically travel to the taxpayers' location in order to perform the collections function, but this has also reduced the costs of operation, the risk of travel, as well as the effectiveness of the DGT's collections function.

The Call Center has requested the use of additional collection officers and a larger physical space for its operations. In a second phase, the DGT Collections Call Center pretends to expand its operations by managing delinquent accounts assigned to the Attorney General's Office in order to further improve revenue levels.

## Strengthening the Large Taxpayers' Office

Improving large taxpayers' compliance in El Salvador is critical for improving tax revenue mobilization. FPEMP's assistance to the large taxpayer office since the first year includes: support the development of a conceptual model including a redefinition of its scope, building an effective audit program, provision of improved taxpayer services to facilitate filing and payment by the largest taxpayers, and capacity building on transfer pricing audit techniques. In the third year of FPEMP, no additional assistance was provided to the large taxpayer office since all plan activities had already been completed and the large taxpayer office is considered to be fully equipped and trained to perform their main duties.

**Table 7 – Status of activities related to supporting the large taxpayers office**

| | |
|---|---|
| Support the large taxpayer office conceptual model | Completed |
| Study tour to Chile to learn about the Chilean Large Taxpayer Directorate | Completed |
| Setting up the new large taxpayer office front and back office | Completed |
| Training on transfer pricing audit techniques | Completed |

| | |
|---|---|
| Study tour to Ecuador to learn about transfer pricing audit techniques | Completed |

During the first year of assistance, FPEMP supported the MOF's strategy to redefine the parameters of clients by reducing the universe of large taxpayers from 1,500 to 639. FPEMP assistance additionally included the establishment of a renewed, one-stop-shop for large taxpayers which brings together the control, collections and taxpayer service functions. This new large taxpayer's office was officially launched during the second year of the program and it integrates front office transaction desks, back office transaction desks (for more complex issues), as well as a DGT collection stand.

In support for further strengthening the large taxpayer office's audit program, FPEMP assisted with the implementation of the large taxpayer office auditors' area. This area was fully adapted and furnished to house 88 auditors' work stations, cabinets and chairs. In addition, the new area comprises 42 waiting chairs, 19 supervisors' chairs, 6 secretarial chairs and an executive meeting table that holds up to 20 people. Since its establishment, the large taxpayer office's front and back office provided assistance into 18,383 transactions in 2013 ranging across various areas. Through April of 2014, already nearly 8,600 assistance transactions had taken place (see table).

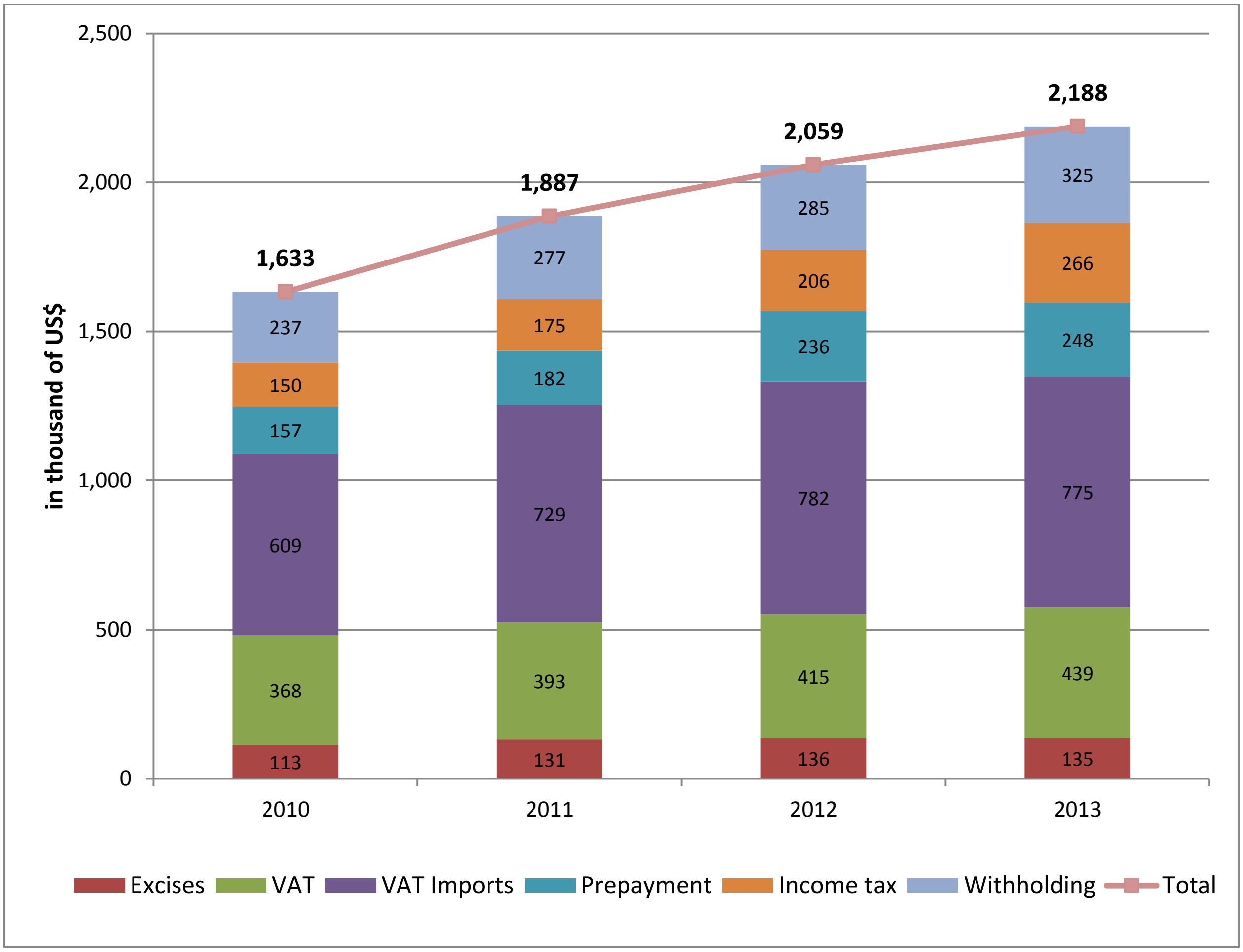
**Table 8 – Large Taxpayers Office' Front and Back Office Assistance**

| | **Area of Assistance** | **Jan – Dic 2013** | **Jan – April 2014** |
|---|---|---|---|
| **Front Office** | Reception of tax statements and reports | 3817 | 4175 |
| | Registration of taxpayers | 6,451 | 1,896 |
| | Requests for tax statements and solvency certificates | 3,481 | 1,075 |
| | Calculation of interest payments | 212 | 102 |
| | Charges of VAT revenue | 2,860 | 780 |
| | Reception of alcohol tax records | 149 | 216 |
| | Resolutions reported to VAT exporters | 670 | 139 |
| | **Subtotal** | **17,640** | **8,383** |
| **Back Office** | Refund requests to VAT exporters | 711 | 210 |
| | Improper payment requests VAT | 20 | 5 |
| | Other domestic payment requests | 12 | 2 |
| | **Subtotal** | **743** | **215** |
| **Total** | | **18,383** | **8,598** |

Source: Large Taxpayer's Office

One of the large taxpayer office's objectives is to perform comprehensive audits on all large taxpayers on a multi-year cycle, through focused audit management strategies. Thus far, the office has performed audits on two thirds of large taxpayers and expects to perform audits on the remaining one third in the next year. Tax collections from large taxpayers represent 58 percent from domestic and import Value Added Tax collections, income tax collections represent 35 percent of collections and 7 percent from excises. The table below presents the trends of revenue collections from large taxpayers. Tax collections have been rising across time, despite the fact that the large taxpayer office was redefined in 2012 from 3,569 taxpayers to 661. The largest increases have come from income tax collections—mainly due to the increase in income tax rates from the tax reform of 2011, but also from Value Added Tax collections.

**Figure 5. Large Taxpayers Office Tax Collections, by type (2010 - 2013)**



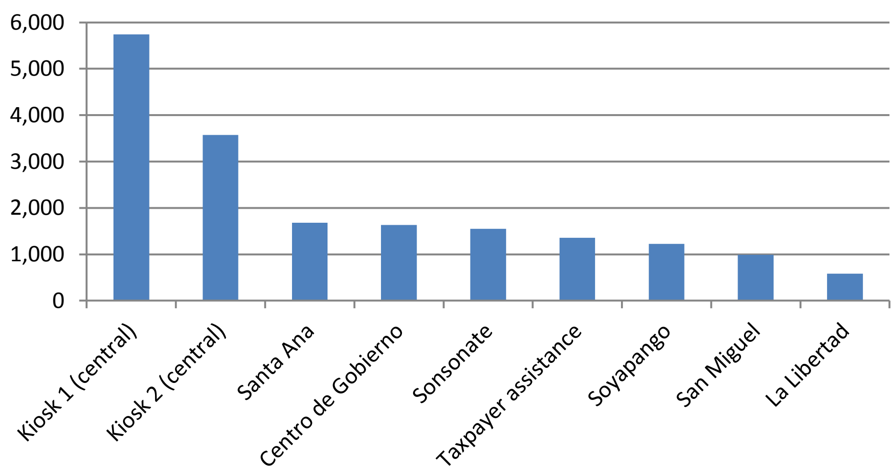

*Source: DGII. * In July 2012, the LTO was redefined from the largest 3,569 taxpayers to the largest 661.*

With regards to transfer pricing capabilities, the large taxpayer office's transfer pricing was initiated in 2008 with USAID's assistance through Tax Policy and Administration program. Through FPEMP, additional capacity building was offered to the unit in addition to a study tour to Ecuador to expose Salvadoran official to latest techniques in transfer pricing audit. In 2013-14, the unit had completed 13 audit cases, of which 3 cases collected nearly $1.7 million in additional tax revenue, and 2 additional ones resulted in voluntary modifications of tax payments amounting to $180,000. Eight more cases are currently in process. The large taxpayer office's unit performed these audits by using data and information available through the U.S. Securities and Exchange Commission (SEC), providing detailed information on company filings. The unit currently lacks access to specialized transfer pricing databases providing detailed information about companies' financials, integrated global companies profiles, which could further enhance its performance for undertaking transfer pricing documentation and analyses.

## Improving taxpayer services to medium and small taxpayers (self-service kiosk system)

The GOES' DGII is committed to improving taxpayer services to medium and small taxpayers. Through taxpayer self-service kiosks, the DGII allows taxpayers to access their tax accounts and perform certain transactions real time. The self-service kiosk system provides instant services for different processes including: tax account inquiry, payment status for VAT, requests for tax transcript statements or solvency statement, information on the tax calendar, and a taxpayer service. Services available at the kiosks help taxpayers avoid long lines at the DGII thus reducing compliance costs for both taxpayers and the tax administration, also reaching remote areas of the country. The Figure below presents a distribution of 18,334 taxpayers transactions performed at kiosks, including personal taxpayer assistance at the DGII, in 2013.

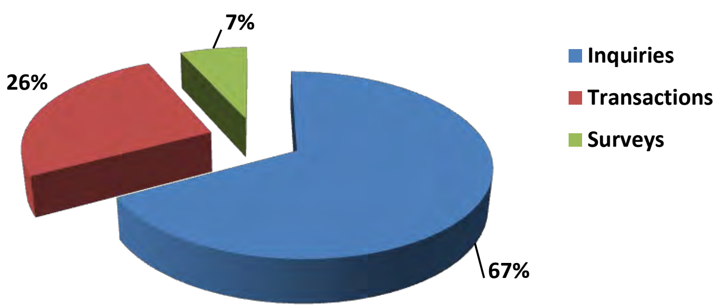
**Figure 6. Number of taxpayer service procedures performed at kiosks**




Source: DGII

FPEMP in coordination with the MOF launched the self-service kiosk system. FPEMP assistance includes the purchase and software development of the modules included in the kiosk system. At the end of November 2012, the program and the MOF had implemented 1 kiosk in the MOF taxpayer assistance center. USAID approved the purchase of another 6 kiosks, which were procured in the third year. With support from the IDB, in 2013 the MOF implemented 9 additional kiosks which have been launched in strategic points of the country, paying particular attention to population concentration and lack taxpayer services. These kiosks use the software technology FPEMP developed. The next figure provides a distribution of procedures performed at self-service kiosks, where 67% of transactions are inquiries, 26% are tax transactions, and 7% are surveys.

**Figure 7. Procedures performed in taxpayer service kiosks, by type (2013)**




At the time of this performance, the DGII informed that the installing of the remaining 6 kiosks purchased through USAID assistance is pending the procurement of electrical wiring and servicing which requires following the competitive bidding process of public procurement. These are expected to be installed by August 2014.

As part of the DGII's effort to disseminate the use of service kiosks, students who are fulfilling community service hours, are serving as agents who during peak times of Value Added Tax payments monthly, inform and advise taxpayers about the use of self-service kiosks and their benefits.

## Other taxpayer services

The DGII requested FPEMP assistance with implementing an electronic queuing system for various taxpayer transactions taking place at the DGII. Additionally, the DGII has requested assistance with developing a "blocking" system which would disallow the issuance of solvency documents and performance of other taxpayer transactions, until the taxpayer is up-to-date with all its obligations and pending matters.

The FPEMP team stands ready to assist the DGII in implementing these two special requests; however, these depend on the migration of the DGII's JSIIT to the JBoss system. This migration by the DGII is slowly progressing achieving migration of 2 out of 22 modules of the tax information system in 2 years. Implementing the blocking system, for instance, requires that all 22 modules be migrated. The queuing system does not necessarily require migration of the system, but this task has been placed on hold.

## Cleaning and updating the TRS and TCA

A clean and up-to-date taxpayer registry and current account contribute to an effective, well-functioning tax administration. The TCA allows the DGII to record and monitor all taxpayer transactions, including debits and credits and calculation of consolidated balances by account type, over time. The TCA is the record that shows the taxpayer's liabilities and payments for all the taxes per registered taxpayer, and also provides a record of all taxpayers' payments in a single account.

The TCA in El Salvador suffered many functional deficiencies as well as weaknesses in the tax administration information system. The FPEMP undertook in the first year a comprehensive assessment of the TCA, identifying weaknesses in the business processes and systems. FPEMP then supported the development of 11 applications integrated in the DGII's IT system, including: error tracking; re-defining the resolutions process; fast query about tax account status via web; taxpayer solvency requests; automated assignment of tax transcript requests; entry of internal applications; selectivity criteria for supervision of solvency requests; reprocessing of data; analysis of applications; and guarantees to the current account. These applications introduced new rules, processes and screens for the end user.

Additionally, in February 2013, FPEMP launched the TCA and TRS Cleaning Project, hiring 20 interns tasked to assist in the cleaning of 21,523 TCA records (of which 273 were large taxpayers) and 7,730 taxpayer registries. By October 2013, all records assigned to the team had been cleansed. As part of the TRS cleaning process, all VAT taxpayers were issued a replacement TIN card, where 610 duplicate records were identified and resolved.

**Table 9 – Status of activities related to the TCA and TRS cleaning**

| | |
|---|---|
| Development of the TRS application update first phase | Completed |
| Development of the TCA application update first phase | Completed |
| Development of the TRS cleaning | Completed |
| Development of the TCA cleaning | Completed |
| Support the TRS cleaning institutionalization | Completed |
| Support the TCA cleaning institutionalization | Completed |
| Support the implementation of the DGII webservices with national banks | In Progress |
| Support the development of the DGII and DGT software interphase | In Progress |

The FPEMP has continued assisting the DGII in the implementation of strategies to help prevent subsequent problems with the TCA, all of which are in progress of being implemented, including:

1. Implementation of web services between the banks and the DGT
2. Implementation of a single payment channel
3. Implementation of DGT catalogues in the TCA transactions
4. Development of a transactions interphase of delinquent taxpayers between DGT and DGII
5. Standardization of the TCA cleaning protocols
6. Improvement of the tax returns data entry
7. Institutionalization of continuous TRS and TCA clean-up process.

As in the case of the TCA, the TRS is also a critical component of the tax administration system, and restoring and protecting its integrity is essential. Of the approximately 4.7 million taxpayers registered in the TRS, only 500 thousand are considered active taxpayers. The FPEMP team supported the updating of numerous TRS modules, including applications for the categorization of taxpayers and risk levels; avoidance of duplicate entries; creation of controls; and TRS adjustments to capture new business rules. The FPEMP team undertook a detailed review of the causes for inconsistencies of the TRS and found the following to be the most critical ones in El Salvador:

1. The taxpayer does not update the information regularly.
2. Typing errors when entering information.
3. Data migration errors (system).
4. Lack of system validations.
5. Misinformation, false, nonexistent or incomplete information provided by the taxpayer.
6. High amount of homonymous records.
7. Lack of standardization of acronyms and abbreviations.
8. Lack of information sharing among the different directorates (i.e. DGII, DGT, Customs General Directorate-DGA)
9. Lack of information cross-checking with external institutions (i.e. RNPN, CNR, municipalities, social Security, among others)

The FPEMP team by the third year had helped to tackle most of the issues related to the pollution of the TRS. Of the 20 interns forming part of the TCA and TRS cleaning project, 10 of them were dedicated to the TRS cleaning. Because the pollution of the TRS and TCA are mainly due to human activity and error (e.g. errors in the fingering of the information, process of migration to different platforms that have been deployed in the search for safer and better computer support, lack of provision of information by the account holder), the FPEMP team recommended and assisted the DGII with the institutionalization of a working group which on a permanent basis will be dedicated to debugging the deficiencies that arise in the information contained in the TRS and the TCA. This unit was officially launched in February 2014 as the "*Area de Depuración de RUC & Registro y Control del Contribuyente*." El Salvador is now considered ahead of many other Latin American countries in terms of achieving a well-functioning TRS and TCA.

## Tax revenue mobilization through the new CSMS II

The CSMS II—in its second generation—has become a powerful tool for the DGII's functions of tax enforcement, tax collection, tax audit, and taxpayer outreach. The CSMS I initiated with assistance from the USAID-funded Tax Policy and Administration project, and its capabilities have been greatly enhanced through the CSMS II developed with assistance from FPEMP. The new CSMS II does not only allow for a newly enhanced substantive risk-based audit, but it also allows for other type of audit plans, including, massive, preventive and corrective audit plans, allowing the automation of taxpayer outreach, calculation of tax declarations, and other type of Value Added Tax and income tax enforcement mechanisms. Additionally, the CSMS II capabilities are cross-cutting through the DGII functions, allowing better control of the traceability of programmed cases, as well as the standardization of workflows for each specific audit plan. The CSMS II is planned to extend through all stages of the audit process, including taxpayer hearings, administrative appeals and judicial appeals.

USAID's assistance to the DGII through FPEMP, has contributed to transforming the CSMS II into what counterparts have referred to as a "monster" system for integral and detailed audit. The following table presents the main features of the CSMS I versus CSMS II. The new CSMS II provides a service architecture model that integrates the entire revenue system. The new system allows the efficient management of files and investigations by eliminating the current overlapping control functions from the different areas, including fiscal compliance and VAT refunds, thus integrating audit efforts into one efficient, coordinated task.

**Table 10 – CSMS I versus CSMS II: Tax audit and fiscal compliance mechanisms**

| CSMS I | CSMS II |
|---|---|
| • Substantive (risk-based) audit | • Substantive audit<br>• Preventive plans<br>• Corrective plans<br>• Massive Plans<br>• Punto Fijo[13]<br>• Fedatarios[14]<br>• Other plans |

The FPEMP team has been developing the CSMS II since its first year of assistance. Relaying on a dedicated team of programmers, FPEMP has achieved great progress to date. The table below provides an overview of the status in developing the different modules contained in the CSMS II.

**Table 11 – Status of activities related to the development of the CSMS II**

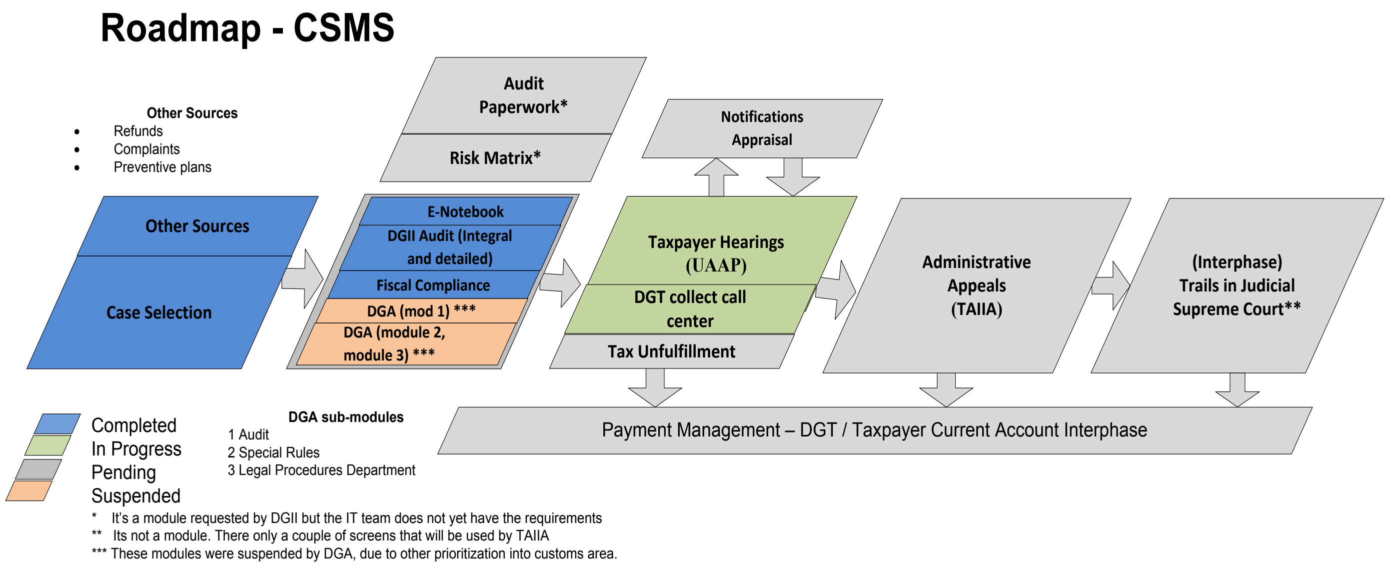
| | |
|---|---|
| Support the design of the CSMS II development strategy | Completed |
| Training program on use cases design to DGII | Completed |
| Support the CSMS II use cases design | Completed |
| Development of the CSMS II selector module | Completed |
| Development of the CSMS II management module | Completed |
| Development of the CSMS II fiscal compliance module | Completed |
| Development of the CSMS II fiscal audit module | Completed |
| Development of the CSMS II portfolio management module | Completed |
| Development of the CSMS II fedatarios module | In Progress |
| Development of the CSMS II punto fijo module | In Progress |
| Development of the CSMS II special plans audit module | In Progress |
| Development of the CSMS II UAAP module | In Progress |
| Development of the CSMS II TAIIA module | Pending |

Through FPEMP the CSMS II's new capabilities include five important modules of the CSMS II, the Selector, Management, Fiscal Compliance, DGII Audit, and E-notebook modules (see figure 8). The Case Selector and Management modules introduce changes to the case selection management and changes in case selection variables, business rules, cloning, execution,

[13] *Punto Fijo* is referred to the fixed site where the tax auditor records sales transactions for a given time period as part of the audit plan.
[14] *Fedatario* is a representative of the tax administration with the obligation to issue and deliver invoices or equivalent documents set out in the tax code.

exporting and case transfers. The Fiscal Compliance module, launched in May 2013, introduces new control flows for contacting taxpayers when the system is showing inconsistent data with various options for contacting taxpayers, including (1) via phone; (2) via mail; (3) via e-mail. Taxpayers are then called to bring documentation and proof that helps clarify inconsistencies in their records.

**Figure 8: The roadmap to the CSMS II: audit and controls flow chain**




**<u>The CSMS II's fiscal compliance and audit modules: a powerful, integrated, comprehensive system</u>**

After launching the fiscal compliance module in March 2013, the FPEMP team proceeded with supporting the development of the DGII's audit module and the DGA audit sub-modules of the CSMS II. While the DGA audit sub-modules where completed by the FPEMP team, the testing of these modules was met with serious challenges due to the DGA's barring access to the SIDUNEA Plus (Customs Information System). As such, this module was suspended and the system will not be deployed until access is granted. Finally, the e-notebook modules' development process (i.e. configuration, use cases, software development and module testing and production) was also completed during the third year.

The fiscal compliance module alone, in 2013, allowed the contacting of 19 thousand taxpayers with inconsistent records (including 6,228 collection email notices in less than 12 hours, 8,931 collection letters in less than 3 days, 2,022 collection calls), helping produce an additional $1.2 million in additional tax revenue (more than US$131,000 from small taxpayers and over US$700,000 in income tax collected during the first 3 days).

During the tax season in 2014, the fiscal compliance and the newly functioning audit modules, allowed the contacting of over 27 thousand taxpayers through various fiscal compliance and audit plan campaigns (including 17,209 salaried employees with tax liabilities greater than $3, and 10,020 legal persons and individual income taxpayers with diverse income sources), helping boost tax revenues by at least $12.7 million ($4.7 million from salaried employees and $8 million from taxpayers with diverse incomes).

The following is a summary of the main results obtained from the CSMS II fiscal compliance campaigns, including massive audit campaigns and substantive risk-based audits.

- **Massive audit ("*Fiscalización masiva*").** The CSMS II allowed the DGII to undertake massive, preventive and corrective audit campaigns, which is a new model put in production since May 2013. The CSMS now allows a massive flow of various taxpayer outreach mechanisms (via email, via mail, and via phone), selecting cases of income taxpayers with tax liabilities due. Most of the process is done paperless as most information is now kept electronically through the different modules and applications found in the CSMS II.

  Through the CSMS II, the portfolio management unit ("gestion de cartera") has reduced the amount of cases processed in the field from 70% to 30%, thus reducing administrative costs, improving targeting and productivity. Additionally, tax audit cases processed through the CSMS II and through this unit, excluding risk-based audits, has an increasing number of cases that can be processed per year, more than doubling the collection generated in 2013, while almost reaching the total amount of 2013 in just the first 4 months of 2014.

  The CSMS II allows the automatic detection of stop-filers, non-filers and sends an electronic mail to taxpayers. The portfolio management unit reports that this change in outreach mechanisms (email versus phone call) allows quick, efficient contacting of taxpayers, in many cases resulting in taxpayers visiting the DGII offices the same day that the email is sent. After the email is sent, taxpayers have 5 days to present themselves to correct their tax issue at the portfolio management unit, the case is otherwise forwarded to the call center, and the field visit represents the last resource. There are currently 3 thousand VAT corrective cases monthly, mostly from taxpayers who have taxes past due.

**Table 12 - Portfolio management unit "massive audit" collections (2010 – 2014)**

| Period | # of cases processed | Collections (in mill $) |
|---|---|---|
| 2010 | 2,825 | $1.30 |
| 2011 | 2,162 | $2.75 |
| 2012 | 3,640 | $1.10 |
| 2013 | 15,627 | $2.60 |
| Jan 2014 – Apr. 2014 | 25,688 | $2.10 |
| **TOTAL** | **49,942** | **$9.85** |

- **Preventive audit (Presumptive income taxation "*declaración de renta sugerida*")**: This preventive campaign applied to income taxpayers (individual and legal persons), using information on taxpayers from the tax withholding agents, the CSMS II produced 'suggested' income tax declarations which were sent to taxpayers ahead of the tax payment due date. The taxpayer has the choice to accept this suggested tax declaration and make a payment against the tax amount due calculated by the DGII (minus any previous payments or amounts withheld), or the taxpayer can contest the tax calculation and forward a revised tax declaration with new tax due amounts which are then processed by the DGII.

Such production of suggested income tax declarations induces taxpayers to accept or contest tax calculations, while facilitating tax compliance and boosting tax revenues. From the nearly 543 thousand active salaried employees, the CSMS II allowed the DGII to identify taxpayers with tax due, after applying prepayments and withholdings. Additionally, the DGII through a study found that the administrative costs of processing a tax declaration is approximately $5.65. Therefore, the DGII programmed the CSMS II to apply this preventive campaign on taxpayers with tax due greater than $3, thus improving efficiency while maximizing the net benefit.

The total amount collected from the more than 17 thousand taxpayers contacted reached nearly $4.7 million (of which $1.95 million was collected in the first three weeks of launching the outreach campaign). The same campaign generated close to $7.7 million in tax revenue from income taxpayers with diverse income sources.

**Table 13 – Salaried Employees, according to tax withholding information (2013)**

| (# of taxpayers) | | | | | |
|---|---|---|---|---|---|
| **Income from** | **To** | **TOTAL** | **With tax refunds** | **With tax due** | **Tax due >$3.00** |
| 0.00 | 4,064.00 | 228,804 | 42,674 | 0 | 0 |
| 4,064.01 | 9,100.00 | 192,170 | 96,057 | 60,485 | 6,848 |
| 9,100.01 | 60,000.00 | 120,374 | 35,198 | 62,534 | 9,458 |
| 60,000.01 | and above | 1,715 | 805 | 903 | 903 |
| **TOTAL** | | **543,063** | **174,734** | **123,922** | **17,209** |
| **(in $)** | | | | | |
| **Income from** | **to** | **Tax Due** | **Payable Tax withholding** | **Tax refunds** | **Tax due** |
| 0.00 | 4,064.00 | $0.00 | $2,684,986 | $2,684,986 | $0.00 |
| 4,064.01 | 9,100.00 | $37,067,543 | $41,929,737 | $5,329,397 | $467,204 |
| 9,100.01 | 60,000.00 | $210,353,733 | $210,918,745 | $3,547,221 | $2,982,209 |
| 60,000.01 | and above | $48,905,187 | $48,102,089 | $444,739 | $1,247,837 |
| **TOTAL** | | **$296,326,464** | **$303,635,558** | **$12,006,345** | **$4,697,251** |

*Source: Case Selection Unit, DGII, El Salvador*

- **Greater accuracy of tax withholding calculations:** The CSMS II, using information from withholding agents, has allowed the more accurate calculation of tax withholding amounts. Salaried employees earning $60 thousand or less are not required filing a tax return, and therefore their tax withheld is a definitive tax payment. In the past, various errors were found in the calculation of amounts withheld by retention agents from salaried employees—most of which applied as definitive tax payments—generally lesser amounts than what should have been withheld. The CSMS II has facilitated more accurate calculation of tax withholdings, producing $10.7 million in additional tax withholdings, and therefore, in additional tax revenue. Furthermore, this same effort has reduced the amounts of tax refunds from $67.6

million in 2012 to $26.9 in 2013. This led to a reduction of 265,746 tax refund transactions from 2012 to 2013. The DGII estimates that each transaction costs $5.65 to process; that is, a $1.5 million in administrative cost savings.

**Table 14 – The CSMS II, tax refund transactions and administrative costs**

| | 2012 | 2013 |
|---|---|---|
| Income tax refund (in $ million) | $67.6 | $26.9 |
| Number of taxpayers | 175,641 | 441,387 |
| *Source: Author's calculations based on data provided by the Case Selection Unit, DGII, El Salvador* | | |

- **Substantive risk-based audit:** In this third year of assistance, audit cases were transferred from the CSMS I and into the CSMS II allowing a more user friendly work environment for auditors. Additionally, since June 2014, the CSMS II integrates data from customs allowing the cross-referencing of information between DGII and DGA, particularly on imports. Since 2013, the GIZ also supports the DGII in this area in the implementation of a risk-based matrix and new detection algorithms. Jointly with the development of the IT infrastructure, the new CSMS II improves the probabilistic models as well as the deterministic magnitude, thus enhancing assertiveness of selected cases. Table 15 presents the number of risk-based cases processed since 2011. The proportion of taxpayers who are audited (VAT and income tax) has increased since 2011, and remains at less than 1 percent.

**Table 15 – Number of active taxpayers and risk-based audits**

| Year | # of taxpayers | # of risk-based audit cases | % of taxpayers audited |
|---|---|---|---|
| 2010 | 727,011 | N/A | |
| 2011 | 751,482 | 454 | 0.06% |
| 2012 | 553,585 | 509 | 0.09% |
| 2013 | 581,749 | 445 | 0.08% |

*Source: Author's calculations with data from DGII.*

The total amount of collections from risk-based audits alone could not be reported by the DGII. The following table includes total collections for all non-massive audit campaigns, including risk-based audits. The DGII has increasingly contributed to identifying increasingly larger amounts of assessed tax liability based on audit assessments. The amount of effective audit tax collections has also been increasing and productivity has been increasing over time, except in 2013, where audit tax collections slightly decrease, but much higher levels of assessed tax liability have been identified. The assessed tax liability that is not yet collected represents taxpayer that do not agree to accept the assessed tax liability determined through the audit assessment, and the case is then transferred to the administrative process that includes a hearing and opening of evidence gathering, tax assessment, which may be appealed by the taxpayer in each of the relevant instances.

**Table 16 – Total tax collections from risk-based audits and preventive campaigns**

| Year | Effective tax collection | Assessed tax liability | Total | Productivity |
|---|---|---|---|---|
| 2010 | $10,911,516 | $58,440,463 | $69,351,979 | 16% |
| 2011 | $14,182,838 | $61,805,562 | $75,988,400 | 19% |
| 2012 | $14,726,816 | $57,277,199 | $72,004,015 | 20% |
| 2013 | $12,387,446 | $74,185,306 | $86,572,752 | 14% |

*Source: Author's calculations with data from DGII.*

**Total production from all audit units**

While the portfolio management taxpayer center has the capacity to attend to 200 taxpayers daily, it is currently attending an average of 100 to 130 daily. It is the DGII's goal to reach to 70 thousand taxpayers in the next year as part of the massive, preventive and corrective campaigns.

The CSMS has allowed enhancing of precision in tax liability calculations, improving efficiencies through reductions in (taxpayer and administrative) compliance costs, improving tax compliance, and facilitating assertiveness in risk-based audits. Enabling the implementation of the 2012 fiscal reform, the CSMS II has contributed to the significant increase in tax revenues from 2012 to 2013 resulting in an additional 1 percentage point of tax revenue to GDP.

The following table provides productivity figures from all audit units using the CSMS II.

**Figure 9. Total Tax Audit Collections using CSMS II, 2010 - 2013**

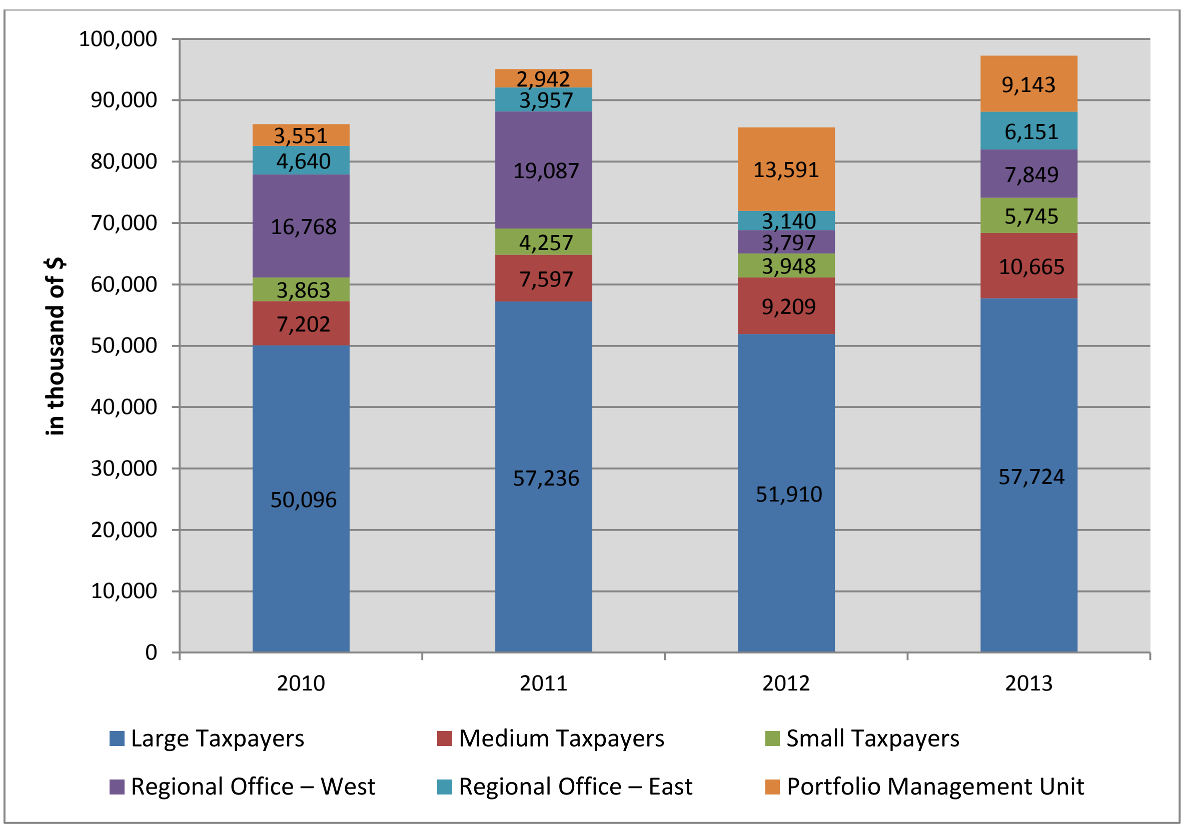


**Table 17 – All audit campaigns using CSMS II, by audit unit, 2010 – 2014**
(in thousands of US$)

| Type | 2010 | 2011 | 2012 | 2013 | 2014 (Jan-Jun) |
|---|---|---|---|---|---|
| Large Taxpayers | 50,096 | 57,236 | 51,910 | 57,724 | 57,605 |
| Medium Taxpayers | 7,202 | 7,597 | 9,209 | 10,665 | 4,737 |
| Small Taxpayers | 3,863 | 4,257 | 3,948 | 5,745 | 2,801 |
| Regional Office – West | 16,768 | 19,087 | 3,797 | 7,849 | 6,592 |
| Regional Office – East | 4,640 | 3,957 | 3,140 | 6,151 | 754 |
| Portfolio Management Unit | 3,551 | 2,942 | 13,591 | 9,143 | 483 |
| Total Audit Collections | **86,120** | **95,075** | **85,595** | **97,277** | **72,973** |

*Source: Case Selection Unit, DGII, El Salvador*

## Challenges ahead for implementing tax revenue mobilization activities

- Retaining a team of skilled programmers who currently support FPEMP's assistance to the MOF in software development for activities related to the CSMS II, but also COMPRASAL II and the SAFI II.
- The DGII's IT platform migration from JSIIT to JBoss is slowly progressing, which affects FPEMP assistance in implementing the "queuing" management system and the "blocking" system.
- DGA's reprioritization of activities has affected the development of the CSMS II's DGA's modules. These have been suspended and may not be reinitiated unless the DGA commits to providing the necessary support in such tasks.
- The GOES is reformulating a fiscal reform package which includes the introduction of new taxes and streamlining of tax expenditures. The private sector has revealed once again great resistance to MOF's proposals. Any fiscal reform package the GOES proposed moving forward has to be carefully formulated. Yet, another area that FPEMP could support.

# OBJECTIVE 3: STRENGHTENED PRIVATE SECTOR OUTREACH

The third main objective of FPEMP assistance is to bridge differences and build consensus between the Government and the private sector. To this end, the GOES must be able to demonstrate its commitment to more efficient, effective, and transparent management of the country's fiscal affairs. There is a critical need to improve the public-private dialogue that provides a mechanism for fostering greater compliance and increasing tax revenues.

While the prospects for forging a national fiscal pact in the first three years of the project dissipated, FPEMP adjusted assistance accordingly focusing on promoting fiscal transparency. As such in the first year of assistance, FPEMP facilitated a joint public-private forum culminating in the development of 15 strategic areas incorporated into a national fiscal transparency policy. FPEMP has been supporting the implementation of specific tasks based on the 15 strategic areas for promoting greater fiscal transparency. The second year of FPEMP assistance contributed to advancing the implementation of some of these areas, including: revamping the MOF's fiscal transparency portal; supporting fiscal education for youth through the EXPRESATE center. Other areas that FPEMP supports since year 1 include the transformation of the MOF's training department into a center of excellence and building a stronger administration through improved human resource utilization.

In the fourth year of the FPEMP, with a change in government (though still FMNL led), a new opportunity arises to enact a fiscal pact. As such, a donor working group including USAID's FPEMP, aims to promote such a pact by developing a white paper on what is now referred to as a "Fiscal Sustainability Agreement." FPEMP began contribution of one chapter on tax revenue mobilization to this white paper. Additionally, in the third year, FPEMP also began supporting a new area on fiscal transparency through a trilateral cooperative agreement between the U.S.-Brazil-El Salvador. This is an effort to promote and implement best practices on fiscal transparency from Brazil, adapted to the GOES. Efforts include an upgrade of the MOF fiuscal transparency portal and support to the GOES in the effort to develop a Fiscal Transparency Portal that includes a Portal for Municipalities. This Municipal Fiscal Transparency Portal will include detailed fiscal data on municipal public finances as well as mechanisms for social audit.

Critical milestones achieved during FPEMP's third year of assistance:

- Launched the International Trilateral Initiative on Fiscal Transparency between the Governments of El Salvador, the United States and Brazil, aiming to promote fiscal transparency and implement best practices for the GOES.
- Launched the Fiscal Transparency Initiative for Municipalities, within the framework of the International Trilateral Imitative, to promote fiscal transparency and citizen audit mechanisms at the municipal level in El Salvador.
- Six members of the MOF technical staff attended the international visitor's program to Brazil to learn about fiscal transparency best practices.

Key quantitative results achieved during FPEMP's third year of assistance:

- Three hundred fourteen (314) employee profiles assessed and updated applying the Competency Based Methodology.
- The program in coordination with the Brazilian counterpart trained 50 GOES staff on best practices on fiscal transparency
- 3,217 is the total number of students who have visited the EXPRESATE program

## Advancing Fiscal Transparency in El Salvador at all levels of government

Following the passage of the Access to Public information Law in December 2011, efforts to promote fiscal transparency in El Salvador have been reinforced through FPEMP assistance. The GOES, through the President's Transparency Division, and the MOF, are committed to demonstrating greater fiscal transparency in the management of public resources promoting initiatives to improve the public's to access to public information that is more flexible, timely, relevant and current.

Since its first year, FPEMP facilitated a joint public-private forum culminating in the development of 15 strategic areas incorporated into a National Fiscal Transparency Policy. FPEMP has been supporting the implementation of specific tasks based on the 15 strategic areas for promoting greater fiscal transparency. The second year of FPEMP assistance contributed to advancing the implementation of some of these areas, including: revamping the MOF's fiscal transparency portal and supporting fiscal education for youth through the EXPRESATE center.

The design of the MOF's fiscal transparency portal is currently in progress, integrating best practices from the Government of Brazil's experience through an international trilateral initiative between the Government of El Salvador, the U.S. and Brazil. The FPEMP program has facilitated the contracting with a local marketing firm which is tasked with developing the design of the portal. The new MOF fiscal transparency portal is expected to launch by December 2014.

**Table 18 – Status of FPEMP activities related to fiscal transparency**

| | |
|---|---|
| Support the development of the fiscal transparency strategic areas | Completed |
| Presentation and validation forum of the fiscal transparency strategic areas | Completed |
| Fiscal transparency strategic areas incorporated in the GOES Transparency and Anticorruption Policy | In Progress |
| Assessment and recommendation to modernize the fiscal transparency portal | Completed |
| Design the strategy for data loading and new dynamic data model of the fiscal transparency portal | In Progress |
| Launch of the Trilateral Initiative (US-Brazil-El Salvador) on Fiscal Transparency | Completed |
| Workshops on Fiscal Transparency | Completed |
| Launch of the Fiscal Transparency Initiative for Municipalities | Completed |
| Redesign of the fiscal transparency portal | In Progress |
| Strategy definition of the social network usage to promote transparency in civil society | Pending |
| Implementation of the social network usage strategy | Pending |

**Launch of the International Trilateral Initiative on Fiscal Transparency: El Salvador, United States and Brazil**

In December 2013, efforts towards promoting fiscal transparency in El Salvador took an important upswing when El Salvador is selected to receive technical support and experience sharing from the U.S. and Brazil, following an important conference on fiscal transparency held in 2013. Consequently, the Government of El Salvador, the U.S. and Brazil launched the International Trilateral Initiative on Fiscal Transparency, in order to improve tax collection, transparency, efficiency and effectiveness of the GOES.

**Box 1. International Trilateral Initiative on Fiscal Transparency: El Salvador--United States--Brazil**



**Launched December 2, 2013**

Under technical assistance from the Government of Brazil and the Government of the United States through the FPEMP, the GOES seeks to establish mechanisms to facilitate and simplify the reporting of public finances to citizens in general. Since, FPEMP has been working on the revamping of the MOF's Fiscal Transparency Portal, incorporating important comparative analysis of the best practices in Brazil, as well as training of MOF officials on issues related to fiscal data and reporting, transparency portal, transparency of municipalities and social audit.[15]

Following the launching of the trilateral initiative, five Brazilian experts from the Brazilian Union Accountability Agency and the Brazilian MOF led the delivery of workshops. Sixteen technical officials from the Salvadoran MOF participated in this five day workshop assessing fiscal transparency in El Salvador, performing a comparative analysis of the fiscal transparency portals in Brazil, and identifying important benchmarks and best practices to apply to the context in El Salvador.

Additionally, the Brazilian experts reviewed the work FPEMP is doing in supporting the MOF in the improvement of the fiscal transparency portal. They endorsed the conceptual model for the MOF developed with FPEMP support, which is developed around the citizens' needs for accurate and proper information and agreed to continue providing technical support throughout the year to review the fiscal transparency portal redesign proposal.

[15] See press release on the launch of this initiative at: http://www.mh.gob.sv/portal/page/portal/PMH/Novedades/Noticias/Noticia?articulo=1097

## International Visitor’s program to Brazil’s Union Controller Office

Following the launching of the trilateral agreement and the initial workshop, in March 2014, FPEMP supported an international visitor’s program to Brazil. The FPEMP in coordination with the Brazilian Union Controller Office (CGU) of Brazil has organized a 5 days learning experience on various aspects regarding fiscal transparency and the Brazilian experience, including:

- Importance of the public’s access to and monitoring of public expenditure data
- Learned lessons in the development of fiscal transparency portals
- Fiscal transparency mechanisms
- Legal framework for promoting fiscal transparency
- Maximization of citizen participation in the use of fiscal transparency portals
- Fiscal data and reporting
- Recommendations and way forward for El Salvador

## Launch of the fiscal transparency initiative for municipalities

As part of the International Trilateral Initiative for Fiscal Transparency, FPEMP also supports a specific initiative for promoting fiscal transparency at the municipal level. In February 2014, FPEMP supported the launch of the Fiscal Transparency Initiative for Municipalities, working in coordination with the USAID-funded project, Municipal Competitiveness. Municipalities were selected to participate according their performance on the competitiveness index, developed by the Municipal Competitiveness project.

The program is working with the GOES in the outlining of a strategy for the fiscal transparency initiative for the municipalities, taking in consideration that there is no standards in the fiscal data produced by them and that they don´t have a GFIS system in place. During the fourth year the program in coordination with the Brazilian counterpart will provide support to the GOES in the strengthening of their capacity to develop and manage the municipal fiscal transparency portal.

## Strengthening social audit

As part of the fiscal transparency initiative, the Ministry of Foreign Affairs of El Salvador, with FPEMP support, delivered a workshop by Brazilian experts in the area of civil society engagement aiming to incorporate specific mechanisms for civil society engagement and social audits as part of the fiscal transparency activities. There were 28 participants representing the Presidency’s Sub-secretary of Transparency and Anti-corruption, FISDL, Ministry of Education, Institute for Access to Information, FUNDE and other NGOs.

During this event, Brazilian experts presented their experience with social audits, including outreach programs through TV and other media, providing information of local budgets and fiscal performance. This initiative aims to incorporate important social audit mechanisms at the national and local levels. At the time of this writing, this activity had recently initiative and follow up activities are expected to take place during the fourth year of FPEMP.

**Box 2. Fiscal Transparency and Civil Society Engagement**

**Led by the Salvadoran Ministry of Foreign Affairs, delivered by Brazilian experts, sponsored by FPEMP. March 27, 2014**

## Supporting Fiscal Education through the EXPRESATE project

During the second year, FPEMP supported the implementation of EXPRESATE, a center for fiscal education reaching high school students within 15 and 20 years old. The program is aimed at creating tax awareness, promoting fiscal responsibility and tax compliance among the youth. The EXPRESATE center was officially launched on March 21st, 2013. The center is a playful area where young visitors take a fun walk around six sections. Each section has its own specific goals intended to promote analysis, discernment and learning of the activities of the Salvadoran MOF. EXPRESATE also promotes the importance for understanding and participating in the country's development, linking the payment of taxes with the country's investments and economic growth.

**Table 19 – Status of Activities related to the implementation of a fiscal education center, EXPRESATE**

| | |
|---|---|
| Support the development of the EXPRESATE center conceptual model | Completed |
| Setting up the EXPRESATE center | Completed |
| Support the EXPRESATE center activities | Ongoing |

The center also uses an innovative approach focusing on the use of multimedia and other technological resources, such as a state-of-the-art computer lab (20 desktops and 2 laptops financed by FPEMP) to learn how to use the MOF Fiscal Transparency Portal and a preview on 'how to file your taxes'. Additionally, students watch a video that depicts the history of taxes in El Salvador and the world. Another hall presents a museum to show preserved historic goods related to the fiscal activity of the MOF. The Hall of Evasion is a special area where students are exposed to the practice of evasion and the consequences of evasion, including poverty, illiteracy, sickness, lack of infrastructure, contraband, and other impediments to the country's development and economic growth. As of May 30th, 2014, the EXPRESATE center has already hosted a total of 3,217 students (of which 1,778 were women).

In the third year and as part of the Partnership for Growth (PFG) event, FPEMP supported the setup of a stand recreating a mini-EXPRESATE at which the more than 400 visitors participated in recreational-informative activities on tax, revenue, and their importance in development and economic growth. Plays and gaming activities were implemented during the all-day fair, and all participants received small promotional items, regardless of their age.

The success of the mini-EXPRESATE at the PFG fair has given rise to considering the establishment of a mobile EXPRESATE, a citizen outreach activity implemented during specific, large public events, with high public attendance. This strategy would not discriminate by age, but instead extends the outreach beyond the youth, providing yet another platform for promoting tax awareness and fiscal responsibility among Salvadorans.

## Building a stronger administration through improved human resource utilization

The FPEMP program supports the MOF and the public financial modernization reforms underway, through a program aimed at improving human resource utilization. The goal is to improve the operational efficiency and productivity of professional staff, strengthening their technical capacities, outlining a clear professional career path, improving employee's performance evaluation, and providing capacity building and training for professional development.

**Table 20 – Status of FPEMP activities related to human resource management**

| | |
|---|---|
| Workshops on technical area profiles development for DGP, DGT, DGICP, DGII, DGA, UNAC and HR Department | Completed |
| Development of the technical area profiles of the MOF | Completed |
| Training on train-the-trainers and training on performance evaluation based on competencies | Completed |
| Development of the MOF HR system based on competencies | Completed |
| MOF HR system based on competencies implementation workshop | Completed |
| Support the implementation of the MOF HR competencies based system | In Progress |
| Institutional reform of the MOF HR Directorate | In Progress |

During the first two years of the program, FPEMP supported the development of the conceptual model and implementation plan for improving human resource utilization through a new modernized Human Resource Management System. Assistance is based on a three step process that began during the second year. The process follows the Competency Based Methodology for Human Resource Management. This methodology is used to integrate all human resources functions with the role of creating a central basis for recruitment and selection, placement of employees, training and development of employees, performance management, career management, promoting employees, and remuneration.

During this process, the FPEMP project performed an assessment of the MOF's technical area employee profiles. Results include 314 employee profiles assessed, technical gaps identified, and profiles were updated applying the Competency Based Methodology. After completion of the assessment and update of the MOF technical area employee profiles, FPEMP supported the development of a curricula matrix, training modules, career training plan and a pilot for performance evaluation applying the Competency Based Methodology for each MOF

Directorate. Each of the directorates involved supported the development of the curricula for their own directorate, including the DGII, DGA, DGP, DINAFI, National Procurement Office, DGCG, General Directorate for Public Investment and Credit, and General Directorate for Fiscal and Economic Policy.

Consequently, FPEMP developed the career plan, and training plan of trainers and performance evaluation. Specialized personnel of each MOF Directorates were involved in the career plans and training plan formulation process. In total, 109 MOF personnel participated in the curricula development process, including 50 women. The career plan development is based on the competency model and follows the curricular matrix previously developed. FPEMP supported the development of five career plans for the following directorates: DGII, DGA, DGP, General Directorate for Public Investment, and DGCG.

The FPEMP project continues supporting the implementation of the MOF Human Resources system based on competencies. While it was expected that at least five functional units would undertake the performance evaluation process in 2014, this has been met with great resistance from the MOF employees union, who have met this as a threat to MOF employees. Despite the fact that the employees' union has been engaged throughout the process, the greatest challenge moving forward will continue to be overcoming the negative perception, but instead further promoting awareness about the benefits of the new model for MOF employees. During this performance evaluation, the MOF's director for general administration has agreed to bring the issue forward to the vice-ministry in order to formulate a clear strategy moving forward.

## Transforming the MOF Training Department into a Center of Excellence

FPEMP continued supporting activities for transforming the DFDMH, into a Center of Excellence. The DFDMH is an important vehicle for implementing all training related to the curricula development through the new Human Resource System. FPEMP supported delivery of training on curricula development in order to facilitate the implementation of the MOF Human Resources System. A total of 13 people attended the training, of which 10 were women. The training was helpful in advancing understanding of participants on the competency-based methodology and its application.

During the second year FPEMP supported the establishing of a state-of-the-art computer lab with capacity for 20 trainees. This includes the procurement of desks, chairs, computers, and audio and video sound systems. Additionally, FPEMP donated 140 chairs for all the other rooms.

In the third year, the FPEMP Capacity Building Expert followed up on the DFDMH capacity building strengthening activities, assessing progress on the training curricula and training courses design for all directorates. Among the recommendations include that the DFDMH has to comply with the implementation plan on the training curricula developed with FPEMP support. Additionally, the assessment identified the DFDMH's important progress in the areas of training program formulation, course planning and design, and training the trainers in competency based evaluation methodology.

**Table 21 –Status of FPEMP activities related to training capacities at the MOF**

| | |
|---|---|
| Assessment and recommendations for the Training Department (DECAMH) modernization | Completed |
| Training on the methodology to elaborate training curricula | Completed |
| Institutional reform of the Training Department (DECAMH) | Completed |
| Training on course development and train-the-trainers | Completed |
| Workshops on curricula development for DGP, DGT, DGICP, DGII, DGA, UNAC and HR Department | Completed |
| Development of the curricula of the MOF | Completed |
| IT procurement for the Training Department (DFDMH) | Completed |
| Setting up the Training Department (DFDMH) computer lab | Completed |

Noteworthy is the fact that the capacity building and human resource expert highlighted the achievements that the Salvadoran MOF has achieved in this area. He recognized the competency based system as one of the most advanced personnel systems in Latin America and other countries in Africa and Asia. Some of the countries are just now beginning to look at creating position descriptions and curriculums, in most cases, using simplified personnel models that do not match the level of detail as what is currently available in El Salvador. Once this system is fully implemented, El Salvador can be a role model for other countries in the region. Overcoming the current challenges with moving forward with the performance evaluations is a critical issue moving forward.

## Supporting the implementation of a Fiscal Sustainability Agreement

In the third year, FPEMP presented to the GIZ and the AECID a proposal for the development of a White Paper on Fiscal Sustainability Agreement for El Salvador. The document would be submitted to the incoming Salvadoran Government to aid in the creation of an agreement with the private sector and civil society to address the complex fiscal environment the country is facing.

The White Paper is a technical concept document presenting a broad approach through different scenarios to the course of actions the Government of El Salvador, once in office after June, 1st 2014. The main objective is to contribute with the GOES' ability to make informed decisions regarding the course of action in order to promote discussions and understanding on the feasibility of undertaking a Sustainable Fiscal Agreement (FSA) to prevent an imminent fiscal crisis.

The White Paper is proposed to be divided into four chapters:

- Chapter 1 is to assess the current status of the public finances and fiscal matters regarding revenues, expenditures, investment and debt and provides an analysis of the tendency based on the last 10 years, to produce forecasts for a 10 years' period, the root causes and the risks the country could be facing if measures are not taken. (To be prepared by AECID).
- Chapter 2 make a presentation on the international experience regarding the fiscal pacts in Latin America and Europe, with a deep analysis on their success and failures.(To be prepared by AECID).
- Chapter 3 presents different scenarios based on the analysis of international experiences and best practices considering the strategic matters that should be included in a SFA, and the best

approaches and measures to be pondered regarding revenues. (To be prepared by USAID/FPEMP).

- Chapter 4 presents different scenarios based on the analysis of international experiences and best practices considering the strategic matters that should be included in a SFA, and the best approaches and measures to be pondered regarding expenditures. (To be prepared by GIZ).

Donor coordination with GIZ and AECID in the development of the white paper for the Fiscal Sustainability Agreement is imminently required. The current fiscal scenario is in a critical state, and it is important for the GOES to further improve tax collection and adjust the public expenditures without sacrificing social investment. At the time of writing, FPEMP already has a consultant on the ground developing the white paper. FEPMP will provide special emphasis on the fiscal transparency and public expenditure tracking by private sector and civil society, as a strategy for improving fiscal accountability and tax compliance.

## Challenges ahead for implementing public-private outreach activities

- Implementation of the Competency based human resource evaluations has faced challenges from the MOF's employees' union. The challenge going forward will continue to be overcoming the negative perception of the new model while further promoting awareness about the benefits of the new model for MOF employees. During this performance evaluation, the MOF's director for general administration has agreed to bring the issue forward to the vice-ministry in order to formulate a clear strategy moving forward.
- While some mayors have already expressed interest, unlike the GOES the municipal level have a very poor data quality in the public finance records and there is no integrated system on budget, investment, accounting and treasury that supports the proper implementation of a strong fiscal portal that follows international best practices. Nonetheless, the approach is to initiate a fiscal transparency practice at the municipal level.
- The implementation of a fiscal sustainability agreement faces many challenges, most of which depend on political economy aspects existent in El Salvador. While FPEMP supports the development of a white paper in conjunction with other donors, ultimate approval of such agreement will require enriched communication mechanisms between GOES and nongovernmental sector as well as broad consensus on fiscal goals, targets, and commitments leading to such fiscal sustainability agreement. FPEMP and the MOF should take careful consideration of the political economy challenges, incorporating aspects concerning the interaction of political and economic processes that will create, sustain and transform the relationship dynamics over time.

# FINDINGS AND RECOMMENDATIONS

This report provides an analysis of FPEMP's third year of assistance to the GOES in advancing its fiscal reform agenda in the areas of public expenditure management, tax revenue mobilization and private sector outreach. Through a detailed review of project reports, technical deliverables, and interviews with GOES counterparts, the FPEMP team, and USAID, findings reveal important achievements through the first three years of FPEMP assistance.

The first year of FPEMP's assistance provided important foundations—assessments, diagnostics, conceptual model development, and implementation plans proposal for the new public financial management system. The second year of the program delivered important output—many of which have already bared fruit—in terms of mobilizing greater tax revenues and improving the efficiency of government operations. This third year evaluation report contains a number of quantitative and qualitative indicators that show important outcomes, helping monitor progress towards achievement of results. Additionally, this evaluation helps identify challenges going forward, helping inform the projects annual work planning, and a strategy for ensuring sustainable results and impact.

Each chapter of this report, related to each of the three areas FPEMP supports, contains a list of challenges to watch for and to overcome in the time going forward. Most of these challenges are concentrated in the public expenditure management component—which by its own nature—is not expected to be an easy task. Improvements in treasury operations, government accounting, e-procurement, and the SAFI II implementation are on track. Special focus should concentrate on the implementation of the budget modernization efforts as well as the implementation of a results-based budget. Expenditure policy should be taken into consideration for achieving improvements in the quality of spending through, for instance, subsidy reform which could provide the fiscal space required to accelerate spending on infrastructure, security, and social programs, without jeopardizing long term fiscal sustainability.

AS FPEMP and other donor projects approach their end date, it is important to consider the GOES' need for continuous assistance during the fiscal reform process which is well underway. Prior USAID investment in fiscal reform in El Salvador through TPAR and other predecessor projects have produced high rates of return on investment, though revenue mobilization, efficiency gains, and government effectiveness, and FPEMP is not an exception. As revealed by important results quantified in this report, coupled with the multi-donor effort for supporting the GOES, the time period going forward represents and unique, critical opportunity for consolidating public finances through implementing sound public financial management in El Salvador.

USAID and the FPEMP team should continue to work in close coordination with the government counterparts and other donor assistance programs to ensure the GOES' continuous, sustainable progress towards results, relying on much needed donor technical assistance to overcome the complex nature of the reform as well as the challenges identified in this report.

# ANNEX 1. RESULTS MATRIX

**Objective 1: Enhanced Public Expenditure Management**

| | Expected Result | Major Achievements | Delivered Project Outputs |
|---|---|---|---|
| a | Enhanced skills in budget formulation, monitoring and evaluation | | As agreed with the MOF, FPEMP will provide training in this area to the 3 ministries that have been assigned to the project, including the ministries of Health, Agriculture and Economy. Work in this area is expected to commence in October 2014. |
| b | Improved budget and policy analysis | | Same as above. |
| c | Accounting and financial controls strengthened | - Completed the GOES' new Chart of Accounts containing over 6,000 accounts and subaccounts, up from 1,000 previously, developed in compliance with international public sector accounting standards. | - FPEMP's government accounting experts worked with the General Directorate for Government Accounting (DGCG) on preparing the adoption strategy—undertaking a detailed gap analysis to identify key accounting and reporting issues, assessment of the chart of accounts, documenting accounting norms and policies and the strategy to develop accounting manuals, and developing a detailed work plan to manage the full IPSAS conversion.<br>-As of May 2014, the GOES enjoys a new chart of accounts containing over 6,000 accounts and subaccounts, up from 1,000 previously, developed in compliance with international public sector accounting standards.<br>-As of May 2014, the government accounting subsystem's 5 out of 25 use cases have been completed serving as the basis for software development and integration into SAFI II.<br>-Additionally, FPEMP brokered the approval for using Costa Rica's Manual of Accounting policies and procedures as the basis for developing the Salvadoran Accounting Manual, helping save time and effort. Developing such manual is still pending.<br>- In the third year, the FPEMP team identified important issues/challenges in the budget execution programming (PEP—Programación de la Ejecución Presupuestaria) methodology, which carries important legal and operational implications in the budget process. Solving such issues is key in proceeding with the budget modernization effort and the FPEMP team has developed a proposal for the PEP's Modification, which is currently under review. |
| d | Operational multi-year ROB knowledge and | | -Worked with the GIZ on the budget modernization plan proposed to the DGP. GIZ will develop the new programmatic budget, medium term expenditure framework |

| | | | |
|---|---|---|---|
| | applications throughout the GOES | | and institutional framework, and ROB methodology and manuals while FPEMP will support the implementation of the system in 12 GOES entities in the second and third year.<br>-In the second year, FPEMP developed a proposal for the functional and administrative organization of the Budget Department, already endorsed by the DGP. |
| e | Improved efficiency of the Treasury to program and manage government funds | -22 of 25 government institutions already operating under a treasury single account.<br>-Consolidated into the treasury single account the approximately 1,600 bank accounts with idle balances totaling $25 million monthly.<br>-Achieved integration of 96 percent of the 11 different commercial banking institutions (the treasury's payment agents) with the Central Bank and TSA system.<br>-GOES payment transactions reduced from 10 days to 2-3 hours. | A diagnosis of treasury operations in the first year of the program highlighted important deficiencies in the cash management function leading to inefficient management of tight cash flows, including the existence of more than 1,600 bank accounts and approximately $25 million in idle balances. Since November 2012, the Treasury General Directorate (DGT) is operating under the new real-time gross settlement system—a real time payment system—contributing to modernizing cash flow management and payment transactions of government obligations. The vendor payment transaction time has been reduced from an average of 10 days to approximately 2-3 hours. As of May 2014, 23 out of 25 institutions are already operating under the TSA system. Additionally, the GOES achieved integration of 96 percent of the 11 different commercial banking institutions (the treasury's payment agents) with the Central Bank and TSA system. As of May 2014, the treasury subsystem's 82 use cases which serve as the basis for software development and integration into SAFI II have been completed. |
| f | A modernized, integrated SAFI enabling consistent budget formulation, execution, and M&E processes across all spending agencies | -Developed conceptual model of new budget system<br>-Budget formulation use cases being developed. Next step: Code generation, software development<br>- Developed the the Annual Procurement Plan module (PAAC—Plan Anual de Adquisiciones y Compras) of the COMPRASAL II. | -Development of the conceptual model for the new budget and financial management system<br>-The new SAFI II brings together various functions including: budgeting formulation, treasury, public investment, budget execution and accountability, procurement, human resources, asset management.<br>-FPEMP team supports the implementation of the SAFI II by supporting the system requirement (use cases) development for the budget execution module, the treasury subsystem and the public accounting subsystem.<br>-FPEMP will also support the full software development of the treasury subsystem and the code generation for the budget formulation and the public accounting subsystem. |

## Objective 2: Improved Revenue Mobilization

| | Expected Result | Major Achievements | Delivered Project Outputs |
|---|---|---|---|
| a | Improved tax revenue mobilization | 15.4% Tax-to-GDP ratio in 2013. Goal: 16% by 2015. | Tax (net) revenue collections augmented by 30 percent from 2010-13. Relative to Gross Domestic Product (GDP), tax revenue increased from 13.5 percent in 2010 to 15.4 percent by the end of 2013, that is almost a two percentage point increase relative to GDP since the beginning of the program. Of the $312 million of additional tax revenue mobilized from 2012 to 2013, we can directly attribute at least |
| B | Sound, coherent tax policy | DGII's Tax Analysis Unit is able to perform analysis on tax benchmarking with minimal donor assistance (a legacy of TPAR). | Updated tax benchmarking study which provides an analysis of the tax structure, performance of the tax system in terms of collections, compliance, evasion and productivity comparing its progress from year to year, and comparing it to other countries in the region. |
| C | Consistent, clean and up-to-date taxpayer records | - 100% current account cleansing completed<br>- 100% of taxpayer records verified | Updating the Taxpayer Registry System (TRS) and Taxpayer Current Account (TCA): The TCA of the Salvadoran tax administration suffered many deficiencies, needing to be cleaned, updated and upgraded in the tax administration information system. By October 2013, the TCA Cleaning Project completed the cleansing of 21,523 records, of which 273 were large taxpayers, completing 100 percent of the total records needing verification. By the end of 2013, the TRS Cleaning Project completed the cleansing of 7,730 taxpayer records, while replacing TIN cards of all these taxpayers while eliminating 610 cases of duplicity. A permanent TRS and TCA cleaning unit has been institutionalized at the DGII, which will continuously cleanse records while safeguarding future pollution. |
| D | Targeted audits and improved tax enforcement | - Launch of new, redefined Large Taxpayers Office<br>- Launch of new Fiscal Compliance Module under CSMSII ($1.2 million in additional tax revenue in 2013) | Improving the Large Taxpayers' Office: Refocused the scope of the large taxpayers' office from 1,500 to the largest 639 taxpayers. FPEMP assistance included establishing a renewed, one-stop-shop for large taxpayers which brings together the control, collections and taxpayer service functions, thus integrating the front office transaction desks, back office transaction desks (for more complex issues), as well as a DGT collection stand. Additionally, FPEMP assisted with the implementation of the large taxpayer office's auditors' area. This area houses 88 auditors' work stations, supporting greater revenue mobilization through audit. |

| | | | |
|---|---|---|---|
| | | | Nearly $2 million of additional tax revenue identified and collected by the LTO' transfer pricing unit in 2013-14.<br>Through the new CSMS II:<br>O The fiscal compliance module of the CSMS II, in 2013, allowed the contacting of 19 thousand taxpayers with inconsistent records (including 6,228 collection email notices in less than 12 hours, 8,931 collection letters in less than 3 days, 2,022 collection calls), helping produce an additional $1.2 million in additional tax revenue (more than US$131,000 from small taxpayers and over US$700,000 in income tax collected during the first 3 days).<br>O During tax season in 2014, the fiscal compliance and the newly functioning audit modules of the CSMS II, allowed the contacting of over 27 thousand income taxpayers through a preventive campaign using suggested tax declarations (including 17,209 salaried employees with tax liabilities greater than $3, and 10,020 legal persons and personal income taxpayers with diverse income), helping boost tax revenues by $12.4 million.<br>O Massive tax audit cases processed through the CSMS II generated $2.6 million in additional revenue in 2013, and $2.1 million in the first 4 months of 2014.<br>O Through the CSMS II, the portfolio management unit ("gestion de cartera") has reduced the amount of cases processed in the field from 70% to 30%, thus reducing administrative costs, improving targeting and productivity.<br>O In the past various errors were found in the calculation of amounts withheld by retention agents from salaried employees—most of which applied as definitive tax payments—generally lesser amounts than what should have been withheld. The CSMS II has facilitated more accurate calculation of tax withholdings, producing $10.7 million in additional tax withholdings and therefore in additional tax revenue.<br>O The CSMS II facilitated the reduction of 265,746 tax refund transactions from 2012 to 2013. The DGII estimates that each transaction costs $5.65 to process; that is a $1.5 million in administrative cost savings. |
| E | Greater fiscal compliance | - Treasury Collections Call Center is fully functional, collected over $3 million in additional tax revenue from tax arrears. | 1. Improving collection of delinquent taxes: Following the success of the Call Center at the General Directorate for Internal Revenue (DGII)—created with USAID's assistance through the predecessor Tax Policy Administration Reform program—FPEMP supported the DGT to set up a Collections Call Center to tackle tax arrears. Established in August 2012 |

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|---|---|---|---|
| | | | and after only 9 months of operations, the Treasury Call Center had helped mobilize over $3 million from tax arrears and income tax resolutions.<br>2. Trained 1,197 persons on new fiscal reforms to facilitate greater understanding and compliance, 93% of persons trained are taxpayers. The number of active taxpayers complying with the VAT increased by 3.6 percent, from 154,681 taxpayers in May 2012 to 60,202 taxpayers in May 2013. The increase in VAT taxpayers by 5, 521 is attributed to the numerous campaigns, fiscal education programs, and dissemination initiatives of 2009 fiscal reform, all of which FPEMP has supported. |
| F | Improved taxpayer services | Six self-service kiosks available at DGII central and regional locations | 1. Implementation of new, redefined Large taxpayers Office--front office which provides taxpayer services to taxpayers in this category.<br>2. Lowering compliance costs of small and medium taxpayers: The self-service kiosk system is an initiative providing instant services for different processes including: tax account inquiry, payment status for VAT, requests for tax transcript statements or solvency statement, information on the tax calendar, and other taxpayer services. Services available at the kiosks help taxpayers avoid long lines at the DGII thus reducing compliance costs for both taxpayers and the tax administration. |

## Objective 3: Strengthened Private Sector Outreach

| | Expected Result | Major Achievements | Delivered Project Outputs |
|---|---|---|---|
| a | Enhanced Communication mechanisms between the GOES and non-governmental sector | -A total of 45 private sector actors attended forum on fiscal matters.<br>-3,217 students have visited the EXPRESATE program | 1. Facilitated forum between the GOES and non-governmental sectors.<br>2. Development and design of EXPRESATE program, a new platform for fiscal education to youth and civil society outreach on fiscal matters.<br>3. Proposal for the development of a White Paper on Fiscal Sustainability Agreement for El Salvador. |
| b | Private sector better understanding and complying with newly enacted fiscal reforms | Training outcome in terms of assistance surpassed expectations. | 1. Training on new fiscal reforms delivered to 1,114 taxpayers.<br>2. 5,521 is the number of additional VAT taxpayers added in 2012-13. |
| c | Better monitoring of public expenditures through public sector and civil society partnership programs | - Mutual agreement between public sector and civil society on 15 Fiscal Transparency Strategic Lines.<br>- Open Budget Index score up from 28 in 2006 to 43 in 2012<br>- 50 GOES staff on best practices on fiscal transparency, including workshops in El Salvador as well as an international visitor's program to Brazil. | 1. Development of 15 Fiscal Transparency Strategic Lines agreed by the private sector on 3 main areas: public financial management, citizen audit and transparency portal.<br>2. Revamping of the MOF's fiscal transparency portal and new design to underway.<br>3. In the third year, FPEMP facilitated the launching and implementation of the International Trilateral Initiative on Fiscal Transparency between the Governments of El Salvador, the United States and Brazil, aiming to promote fiscal transparency and implement best practices for the GOES.<br>4. The FPEMP team continues to support the launching of an enhanced fiscal transparency portal—expected December 2014—which will include a site for municipal data and social audit mechanisms. |
| d | Functional state of the art in-house training program for MOF personnel | - Launch of the new MOF training department, "Ministry of Finance Training and human Talent Development Department" (DFD-MH).<br>- Implementing new Competency Based Methodology for Human Resource Management | 1. Assessment, evaluation and design of new MOF's training center.<br>2. Improving human resource utilization through Competency Based Methodology for Human Resource Management, integrating all human resources functions—recruitment and selection, placement of employees, training and development of employees, performance management, career management, promotions, and remuneration.<br>3. FPEMP also supports a change management strategy—to facilitate acceptance and adoption of the upcoming changes, leading to improved competencies.<br>4. Trained personnel on curricula development, facilitating the |

| | | | |
|---|---|---|---|
| | | - Three hundred fourteen (314) employee profiles assessed and updated applying the Competency Based Methodology. | implementation of the new MOF's Human Resources System. |

# ANNEX 2. Tax Revenue Collections, El Salvador (2004 – 2013)

| | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|---|---|---|---|---|---|
| (in Millions of US dollars) | | | | | | | | | | |
| Gross Tax Revenue | 1,925 | 2,229 | 2,574 | 2,877 | 3,089 | 2,836 | 3,072 | 3,487 | 3,685 | 3,944 |
| **Net Tax Revenue** | **1,819** | **2,132** | **2,488** | **2,724** | **2,886** | **2,609** | **2,883** | **3,193** | **3,434** | **3,746** |
| VAT | 952 | 1,104 | 1,308 | 1,389 | 1,461 | 1,251 | 1,433 | 1,574 | 1,677 | 1,731 |
| Income Tax | 534 | 668 | 788 | 933 | 1,004 | 949 | 996 | 1,127 | 1,250 | 1,479 |
| Custom Duties | 174 | 181 | 200 | 203 | 179 | 138 | 151 | 167 | 180 | 199 |
| Excises | 77 | 95 | 97 | 98 | 96 | 100 | 120 | 140 | 146 | 145 |
| Other taxes | 16 | 17 | 19 | 22 | 38 | 61 | 72 | 72 | 65 | 66 |
| Special Contributions | 67 | 67 | 76 | 78 | 108 | 111 | 111 | 112 | 116 | 126 |
| (in percent of GDP) | | | | | | | | | | |
| Gross Tax Revenue | 12.2 | 13.0 | 13.9 | 14.3 | 14.4 | 13.7 | 14.3 | 15.1 | 15.5 | 16.3 |
| **Net Tax Revenue** | **11.5** | **12.5** | **13.4** | **13.6** | **13.5** | **12.6** | **13.5** | **13.8** | **14.4** | **15.4** |
| VAT | 6.0 | 6.5 | 7.0 | 6.9 | 6.8 | 6.1 | 6.7 | 6.8 | 7.1 | 7.1 |
| Income Tax | 3.4 | 3.9 | 4.2 | 4.6 | 4.7 | 4.6 | 4.7 | 4.9 | 5.3 | 6.1 |
| Custom Duties | 1.1 | 1.1 | 1.1 | 1.0 | 0.8 | 0.7 | 0.7 | 0.7 | 0.8 | 0.8 |
| Excises | 0.5 | 0.6 | 0.5 | 0.5 | 0.4 | 0.5 | 0.6 | 0.6 | 0.6 | 0.6 |
| Other taxes | 0.1 | 0.1 | 0.1 | 0.1 | 0.2 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| Special Contributions | 0.4 | 0.4 | 0.4 | 0.4 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 |
| GDP (Current) | 15,798 | 17,094 | 18,551 | 20,105 | 21,431 | 20,661 | 21,418 | 23,095 | 23,787 | 24,259 |

*Source: General Directorate of Internal Revenue (DGII) El Salvador. Other taxes include property transfers, migration and tourism, incoming long distance phone calls, and vehicle registration. Special Contributions include: FOVIAL, Sugar, tourism, and public transport.*

# ANNEX 3. LIST OF PERSONS INTERVIEWED

## A. USAID

1. Mr. Martin Schulz, COR, USAID El Salvador

## B. GOVERNMENT OF EL SALVADOR, MINISTRY OF FINANCE

1. Mr. Roberto Jesus Solorzano, Vice-Minister of Finance
2. Mr. Guillermo Alfredo Posada Sánchez, Director of the MOF's General Administration
3. Ms. Dinora Margarita Cubias Umaña, Director of DINAFI
4. Mr. Miguel Santeliz, Deputy Director of DINAFI
5. Mr. Juan Murillo, Director of DGT
6. Mr. José Lino Trujillo Barahona, Deputy Director of DGT
7. Mr. Carlos Gustavo Salazar Alvarado, Director of DGP
8. Mr. Mario Villatoro, Deputy Director of DGP
9. Mr. Inmar Rolando Reyes, Director, Director of DGCG
10. Mr. Humberto Barrera Salinas, Deputy Director of DGCG
11. Mr. Ramon A. Perez, Deputy Director of DGII
12. Mr. Jorge Luis Martinez Bonilla, Director of the Large Taxpayer Office, DGII
13. Mr. Juan Ramon Marin, Large Taxpayer Office, DGII
14. Mr. Erwin Villacorta, Large Taxpayer Office, DGII
15. Mr. Raul Anaya, , Chief of Tax Obligations Control Division, DGII
16. Ms. Carmen Maria de Mancia, Chief of Registry and Taxpayer Assistance Division, DGII
17. Mr. Luis Conde, Chief of IT Unit, DGII
18. Mr. Luis Canjura, Director of Tax Analysis Unit, DGII
19. Mr. Oscar Augusto Larin, Tax Analysis Unit, DGII
20. Mr. Jeremias Aguilar, Chief of Case Selection Unit, DGII
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## C. FPEMP

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30. Mr. Luis Domingo Rueda, FPEMP Consultant, Budget Execution
31. Mr. Alex Rivera, FPEMP Consultant, Comprasal II

# ANNEX 4. LIST OF DOCUMENTS REVIEWED AND OTHER SOURCES

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