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BRAZIL

FISCAL MANAGEMENT MODERNIZATION PROJECT FOR THE STATE OF BAHIA — PROFISCO II-BA (BR-L1533)

TWELFTH INDIVIDUAL LOAN OPERATION UNDER THE CONDITIONAL CREDIT LINE FOR INVESTMENT PROJECTS (CCLIP) FISCAL MANAGEMENT MODERNIZATION PROGRAM IN BRAZIL — PROFISCO II (BR-X1039)

LOAN PROPOSAL

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ABBREVIATIONS

CCLIP	Conditional Credit Line for Investment Projects
CONSEF	Conselho de Fazenda Estadual [Bahia's Taxpayer Council]
FIPLAN	Sistema Integrado de Planejamento, Contabilidade e Finanças do Estado da Bahia [Integrated Planning, Accounting, and Finance System of the State of Bahia]
IBGE	Instituto Brasileiro de Geografia e Estatística [Brazilian Institute of Geography and Statistics]
ICB	International competitive bidding
ICMS	Imposto sobre Circulaçao de Mercadorias e Prestação de Serviços [goods and services sales tax]
IPVA	Imposto sobre a propriedade de veículos automotores [motor vehicle ownership tax]
IRR	Internal rate of return
MD-GEFIS	Maturidade e Desempenho da Gestão Fiscal [fiscal management maturity and performance assessment]
NBC	Normas Brasileiras de Contabilidade [Brazilian Accounting Standards]
NCB	National competitive bidding
OSCIP	Organização da Sociedade Civil de Interesse Público [Association of Public Interest Civil Societies]
PCR	Project completion report
PCU	Project coordination unit
PDTI	Plano diretor de tecnologia da informação [Information Technology Master Plan]
PGE	Procuradoria Geral do Estado [Office of the State Attorney General]
PROFISCO	Fiscal Management Modernization Program in Brazil
QCBS	Quality- and cost-based selection
REDESIM	Rede Nacional para a Simplificação do Registro e da Legalização de Empresas e Negócios [National Network for Simplifying the Registration and Legalization of Enterprises and Businesses]
RPV	Requisições de Pequeno Valor [small value requisitions]
SAEB	Secretaria da Administração do Governo do Estado da Bahia [Administration Department of the State of Bahia]
SEFAZ/BA	Secretaria da Fazenda do Estado da Bahia [Finance Department of the State of Bahia]
SPED	Sistema Público de Escrituração Digital [Digital Public Accounting System]
STN	Secretaria do Tesouro Nacional [National Treasury Department]
TCE/BA	Tribunal de Contas do Estado da Bahia [Bahia State Audit Office]

PROJECT SUMMARY

BRAZIL
FISCAL MANAGEMENT MODERNIZATION PROJECT FOR THE STATE OF BAHIA — PROFISCO II-BA (BR-L1533)
TWELFTH INDIVIDUAL LOAN OPERATION UNDER THE CONDITIONAL CREDIT LINE FOR INVESTMENT PROJECTS (CCLIP)
FISCAL MANAGEMENT MODERNIZATION PROGRAM IN BRAZIL — PROFISCO II (BR-X1039)

Financial Terms and Conditions				
Borrower:			**Flexible Financing Facility**[a]	
State of Bahia			**Amortization period:**	25 years
Guarantor:				
Federative Republic of Brazil			**Disbursement period:**	5 years
Executing agency:				
State of Bahia, through the Finance Department (SEFAZ/BA)			**Grace period:**	5.5 years [b]
Source	**Amount (US$)**	**%**	**Interest rate:**	LIBOR-based
IDB (Ordinary Capital):	40,000,000	90	**Credit fee:**	[c]
			Inspection and supervision fee:	[c]
Local:	4,500,000	10	**Weighted average life:**	15.25 years
Total:	44,500,000	100	**Currency of approval:**	United States dollars

Project at a Glance
Project objective/description: The project objective is to contribute to the fiscal sustainability of the State of Bahia through: (i) the modernization of fiscal management; (ii) the upgrading of the tax administration; and (iii) better public expenditure management. This project is the twelfth individual loan operation under the PROFISCO II CCLIP (BR-X1039) approved by the Board of Executive Directors under Resolution DE-113/17.
Special contractual conditions precedent to the first disbursement of the loan: (i) the borrower's adherence to the program Operating Regulations, previously approved by the Bank for all individual operations under the PROFISCO II CCLIP; and (ii) the creation of the project coordination unit and the appointment of its members (paragraph 3.4). **Special contractual conditions for execution:** Before starting to execute activities that have outputs geared toward the Administration Department or the State Attorney General's Office, SEFAZ/BA will sign cooperation agreements with the respective entities to establish the roles and responsibilities of the parties during execution (paragraph 3.5).
Exceptions to Bank policies: None.

Strategic Alignment						
Challenges:[d]	SI	☐	PI	☑	EI	☐
Crosscutting themes:[e]	GD	☐	CC	☐		☑

[a] Under the terms of the Flexible Financing Facility (document FN-655-1), the borrower has the option of requesting changes to the amortization schedule as well as currency, interest rate, and commodity conversions. The Bank will take operational and risk management considerations into account when reviewing such requests.

[b] Under the flexible repayment options of the Flexible Financing Facility, changes to the grace period are permitted provided that they do not entail any extension of the original weighted average life of the loan or the last payment date as documented in the loan contract.

[c] The credit fee and inspection and supervision fee will be established periodically by the Board of Executive Directors as part of its review of the Bank's lending charges, in accordance with the relevant policies.

[d] SI (Social Inclusion and Equality); PI (Productivity and Innovation); and EI (Economic Integration).

[e] GD (Gender Equality and Diversity); CC (Climate Change and Environmental Sustainability); and IC (Institutional Capacity and Rule of Law).

I. DESCRIPTION AND RESULTS MONITORING

A. Background, problem addressed, and rationale

1.1 This project is the twelfth individual loan operation under the Conditional Credit Line for Investment Projects (CCLIP) for the Fiscal Management Modernization Program in Brazil (PROFISCO)-II (BR-X1039) approved by the Board of Executive Directors under Resolution DE-113/17 with a view to building on the progress made by the PROFISCO I CCLIP (BR-X1005) and continuing to modernize the states' fiscal management.

1.2 The PROFISCO II CCLIP (BR-X1039) was approved in 2017 in the amount of US$900 million to contribute to fiscal sustainability through: (i) the modernization of fiscal management; (ii) the upgrading of the tax administration; and (iii) better public expenditure management. Under the PROFISCO II CCLIP, agencies of Brazil's 26 states, together with those of the Federal District and the Federative Republic of Brazil, which receive a favorable recommendation from the External Financing Commission of the Ministry of Planning, will be eligible as borrowers for the preparation of an individual operation.

1.3 The PROFISCO II CCLIP (BR-X1039) is geared toward increasing revenue collection and improving the country's business environment and competitiveness and was primarily designed to support: (i) the supplementation of the Digital Public Accounting System (SPED) by automating tax auditing and including tax obligations, which will lead to the elimination of at least 12 monthly tax returns per taxpayer; (ii) an improvement in public procurement, with the use of benchmark prices, reducing costs and processing times; and (iii) the strengthening of processes, methodologies, and technologies already launched under the PROFISCO I CCLIP.

1.4 **Brazil's economic and fiscal considerations.** Between 2014 and 2016, Brazil's gross domestic product (GDP) contracted 6.9% in real terms. It was not until 2017 that the country managed to return to growth (1.0%), which remained at approximately the same level in 2018. Economic growth is expected to be around 0.9% in 2019 and 2% in 2020.[1]

1.5 The decline in economic activity caused a significant drop in the revenue of the consolidated public sector, which translated into a loss of about three percentage points of GDP between 2013 and 2018 (from 34.5% in 2013 to 31.3% in 2018). Due to inertia, public expenditure grew steadily during this period from 37.4% of GDP in 2013 to 38.1% in 2018.[2] Consequently, the federal government saw primary deficits (2.5%, 1.8%, and 1.7% of GDP in 2016, 2017, and 2018) and a significant reduction in public investment (24.2% decrease between 2014 and 2017). Public debt rose from 60% of GDP in 2013 to 78.6% of GDP in 2018 and is estimated to potentially exceed 90% of GDP in 2023.[3]

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1 Brazilian Institute of Geography and Statistics (IBGE) and Central Bank of Brazil, 2019.

2 Tesoro Transparente.

3 International Monetary Fund, October 2019.

1.6 To mitigate the crisis, the federal government is taking economic measures to promote fiscal sustainability. The pension system reform was approved in the Chamber of Deputies and the Senate. Bills on the fiscal balance program of subnational governments and on economic freedom, which reduces bureaucracy and improves the business climate, were submitted to Congress. Various tax reform proposals, including the creation of the national value-added tax, are under discussion in the National Congress. Lastly, the federal government is accelerating the infrastructure concession and privatization program.

1.7 **Fiscal position of the State of Bahia** (National Treasury Department (STN), 2019). As a result of the economic crisis that impacted the country, Bahia's GDP fell from average annual growth of 5.8% between 2003 and 2013 to 2.73% in 2014, -1.12% in 2015, and -0.69% in 2016.[4] This slowdown in economic activity affected the State's public accounts, which have been plagued by lower public revenue growth and higher public expenditure. The primary balance as a percentage of the state's GDP therefore fell from an average surplus of 0.80% between 2002 and 2014 to -0.43% in 2015 and -0.52% in 2016, with significant impacts on the State's fiscal sustainability.

1.8 Bahia's net current revenue fell from average annual real growth of 5.5% between 2003 and 2013 to 4.7% in 2014, then rose to 7.7% in 2015 (due to an 11.6% increase in current transfers), before dropping to -0.08% in 2016. More recently, net current revenue grew 1.6% in 2017 and 4% in 2018. This result is heavily influenced by the collection of the goods and services sales tax (ICMS), which accounts, on average, for 54% of net current revenue. Bahia is highly dependent on federal government transfers (30.3% in 2018) and was adversely affected by the reduction in the growth of the State Revenue-sharing Fund, which declined from average annual real growth of 8.7% between 2002 and 2011 to 2.4% between 2012 and 2018 (STN, 2019). On the expenditure side, from 2002 to 2018, the average real growth rate of current expenditure was 6.1%, due mainly to an increase in payroll expenses, which rose by 7.5% during the same period from 45% of current expenditure in 2002 to 55.4% in 2018.

1.9 As for the requirements of the Fiscal Responsibility Law, Bahia complies with the limits of the payroll expenses/net current revenue indicators (59.42% in 2018, compared to a limit of 60%); the debt payment capacity indicator[5] (75.11% in 2018, compared to a payment capacity B limit of less than 150%); the current savings payment capacity indicator (96.33% in 2018, compared to a payment capacity B limit of less than 95%); and the liquidity payment capacity indicator (108.46% in 2018, compared to a payment capacity A limit of less than 100%) (STN, 2019).

1.10 To deal with lower revenue growth and higher current expenditure, part of the fiscal adjustment entailed reducing investment spending. While investment expenditure accounted for 8.8% of the total in 2010, in 2018 it represented just 5.6% (STN, 2019).

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4 IBGE. The year 2016 is the last year with statistics available for all Brazilian states. Bahia is the sixth largest economy in Brazil.

5 The payment capacity calculation methodology considers three indicators: (i) debt (consolidated debt/net current revenue); (ii) current savings (current expenditure/current revenue); and (iii) liquidity index (financial obligations/available resources). The rating assigned ranges from A, excellent fiscal position, to D, poor fiscal position.

1.11 **Rationale.** The country's slow economic recovery and the state's vulnerability underscore the need to implement new fiscal management modernization actions in order to keep the public accounts balanced and consolidate their fiscal sustainability. New and complementary approaches are also needed to enhance the state's fiscal performance. PROFISCO I-BA (2914/OC-BR)[6] placed strong emphasis on improving the tax administration and promoted the integration of the state tax authority with other levels of government through the SPED update and an increase in its own revenue collection by using SPED information and automated tools that will allow information to be cross-checked and for census nets and remote control to be used for oversight of goods in transit. It also implemented new functionalities in the Integrated Planning, Accounting, and Finance System (FIPLAN) to support new requirements and promote integration with other government systems. Through these efforts, Bahia managed to offset some of the effects of the crisis, mainly by increasing its own revenue collection and facilitating tax compliance. This project will further these lines of action and will promote: (i) the enhanced administration of public expenditure; (ii) the use of SPED and digital technologies; and (iii) the simplification of tax compliance to improve the business environment.

1.12 The effectiveness and efficiency of public institutions are hampered by the restrictions faced by their officials, access to information technologies, the availability of financial resources, and the legal framework (Arenas de Mesa, 2016; Finan et al., 2017). The empirical evidence shows the need to establish strong fiscal institutions to consolidate an environment that promotes fiscal sustainability (Poterba, 1999). In this respect, the Finance Department of the State of Bahia (SEFAZ/BA) neess to address the remaining weaknesses limiting its fiscal performance. In terms of human resources, SEFAZ/BA has 2,914 employees,[7] 58.8% of whom are eligible for retirement. It does not, however, have a management model or evaluation and scaling up procedures to quantify and shed light on the profiles and composition of its staff, which is why staff allocation does not address current and future needs or allow for better skills-based training.

1.13 With respect to technological infrastructure constraints,[8] some of SEFAZ/BA's computer equipment was modernized with 1,365 desktops, 300 notebooks, and hardware and software for the Data Center; however, close to 40% of all computers are, on average, 4.5 to 5.5 years old. The ability to store data (370 terabytes today) is insufficient to meet the demands of new technologies and to process large volumes of data. SEFAZ/BA has an inventory of 4 billion fiscal documents, but hardly uses this information. There are also deficiencies in governance, such as the absence of an Information Technology Master Plan (PDTI), and similar plans for information security and disaster recovery environment.

6 PROFISCO I-BA project completion report.

7 Bahia's Human Resources System.

8 Technical note - Information technology management model implemented.

1.14 As for the legal framework, there are weaknesses in the rules for granting and supporting fiscal incentives, as there are still 45 legislative instruments on these matters and 107 incentive modalities for close to 2,000 enterprises without proper control.[9] In addition, to fulfill their ICMS fiscal commitments, taxpayers have to file various tax returns that duplicate processes when a single return would suffice.[10]

1.15 There are other major challenges to strengthening Bahia's fiscal sustainability, which were identified through the implementation of the Fiscal Management Maturity and Performance Assessment (MD-GEFIS)[11] and in the problems, solutions, and policy matrix, an instrument used to define outputs and activities, based on the identified problems and challenges, set out below.

1.16 **Financial management and fiscal transparency.** SEFAZ/BA corporate processes related to institutional governance, staff and technology management, and fiscal transparency and citizenship are insufficiently developed and integrated,[12] which limits its institutional performance. This is a result of:

a. **Lack of long-term strategic planning to guide the decision-making process[13]** because: (i) policies and guidelines are not formally established; (ii) there are no indicators, mechanisms, or instruments to evaluate organizational results; (iii) there are no indicators to monitor projects; and (iv) institutional risks are not identified.

b. **Professional development actions not aligned with organizational strategies[14]** due to: (i) the lack of a knowledge management model; (ii) training with actions provided mainly by request, without learning paths and with inadequate physical infrastructure; (iii) an ineffective performance evaluation model; and (iv) limited capacity to promote the exchange of experiences by SEFAZ/BA technical staff.

c. **The information technology (IT) management model is not aligned with the new digital transformation processes[15]** due to: (i) the lack of a PDTI and performance metrics to evaluate services; (ii) insufficient computing infrastructure to store and process electronic fiscal documents, related to the absence of a contingency computing environment for disaster recovery; and (iii) an outdated IT security policy and the absence of mechanisms to combat cyber attacks.

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[9] The tax expenditure amount resulting from tax incentives in 2019 is estimated to be around R$3.6 billion, according to the SEFAZ/BA Superintendency of Tax Administration.

[10] At present, taxpayers must file three returns per month with SEFAZ/BA to fulfill their tax obligations, which represents close to 200,000 hours of work per year.

[11] MD-GEFIS report and MD-GEFIS matrix.

[12] MD-GEFIS report: Three of the six fiscal management areas have a basic maturity level, whereas the three others are barely intermediate.

[13] Technical note - Public governance and results-based management model implemented: Lack of strategic planning and methodology for project management.

[14] Technical note - Model for the professional development of SEFAZ staff: Lack of knowledge management model and learning paths, and training provided mainly by request.

[15] Technical note - Information technology management model implemented: Lack of a PDTI and tools to combat cyber attacks.

d. **Inefficiency in public procurement processes**[16] due to: (i) the lack of a strategic procurement plan for the state, an integrated material, asset, and services system, and standardized procedures in decentralized government units; and (ii) nonstandardized work process with low automation and with obsolete and nonintegrated systems.

e. **Ineffective internal control system**[17] due to: (i) the limited implementation of the risk management program in just a few state bodies and the lack of an integrity program; (ii) a transparency portal with limited information;[18] (iii) the lack of electronic monitoring tools; and (iv) the lack of a methodology for conducting performance-based audits.

1.17 **In the tax administration**, revenue collection performance is still limited relative to its potential.[19] This is a result of:

a. **Risk of revenue collection loss as a result of inefficiencies in tax policy formulation**[20] due to: (i) weak control of cumulative tax claims; (ii) a tax policy formulated without an economic analysis or a tax gap evaluation; and (iii) poor management of tax benefits due to the lack of a support system and methodologies.

b. **High cost for taxpayers to fulfill tax obligations**[21] due to: (i) the requirement to file a monthly ICMS return and ancillary tax returns; (ii) the failure to implement the National Network for Simplifying the Registration and Legalization of Enterprises and Businesses (REDESIM); and (iii) the failure to integrate import and export systems into the Unified Foreign Trade Portal, making real-time processing impossible.

c. **Inefficiency in processing data to produce information based on Big Data**[22] due to: (i) the lack of a long-term information management strategy; (ii) the lack of a data mining methodology; (iii) nonintegrated data management systems; and (iv) unstructured databases limiting information generation.

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16 Technical note - Material management and procurement: Limited control of decentralized procurement, tiered pricing between government bodies, and nonpriority procurement of goods.

17 Technical note - Internal control and transparency model implemented: Limited prevention activities and just 10% of audits focused on performance.

18 Bahia's Transparency Portal ranks 22nd among the 27 states on the Brazil scale.

19 Tax evasion in Brazil is estimated to represent 7.6% of the country's GDP. SINPROFAZ, 2016.

20 Technical note - Fiscal and expenditure policy: Lack of fiscal gap estimation methodology; 107 tax benefit modalities without adequate control.

21 Technical note - Registration and obligations: Average time of 200,000 hours per year of work for taxpayers to prepare and send out tax payment guides.

22 Technical note - Big Data information management: 4 billion data elements available without strategic use.

d. **Limited oversight model efficiency** due to: (i) the time gap between the operative event and oversight, making tax claim recovery difficult; (ii) the limited capacity to oversee all taxpayers[23] and promote taxpayer self-regulation; (iii) the incompatibility of the current oversight model with the new reality of electronic fiscal documents; and (iv) the reactive nature of fiscal intelligence, which makes it difficult to identify organized fraud from its inception.

e. **Outdated model for the adjudication of tax litigation cases with low technology use[24]** due to: (i) the lack of tools (software and hardware) to automate and streamline work routines and activity oversight; (ii) a Fiscal Administrative Process Regulation that is not aligned with the Code of Civil Procedure (Law 13,105/15); and (iii) the public's difficulty in consulting documents of the Bahia Taxpayers' Council (CONSEF) and the tax adjudication sections online.

f. **Inefficiency in taxpayer services units** due to: (i) the fact that most services available on the Internet cannot be completed online from start to finish and require taxpayers to visit taxpayer services units in person;[25] (ii) the absence of a system to search for services or consult legislation; (iii) the limited interaction with citizens and accountants; and (iv) the inadequacy of the physical facilities of some tax administration units for their operations and the provision of services to citizens.

g. **Inefficient tax claim collection[26]** due to: (i) the lack of an inheritance and gifts tax management system, the technological gap in systems for the collection of revenue, credits, and the motor vehicle ownership tax (IPVA), as well as limited integration of the Online Tax Administration Process with collection and credit systems; and (ii) a manual collection process, without a defined methodology or standardization.

1.18 Deficiencies exist **in the financial administration and in public expenditure management**, making it difficult to achieve better results in terms of fiscal discipline and efficiency and in public expenditure effectiveness. The causes of this are:

a. **An inefficient financial administration process[27]** due to: (i) the lack of standardized process and procedure flows for financial administration activities; (ii) lack of methodologies to simulate scenarios; (iii) absence of automatic alerts of possible delays; (iv) low intersystem integration; (v) the manual reconciliation of most bank accounts; and (vi) manual payroll input in FIPLAN.

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[23] Technical note - Fiscal inspection and intelligence: In 2018, 1,150 taxpayers from a database of 145,000 and 2,241 fiscal current account taxpayers from a database of 32,395 were inspected.

[24] CONSEF: The adjudication of a tax litigation case in second instance takes on average 885 days.

[25] Technical note - Taxpayer service template implemented: Just 10 of the 114 services are provided online; close to 620,000 in-person visits per year.

[26] Technical note - Tax enforcement and collection: Tax credit recovery is around 6.5% annually.

[27] Technical note - Financial execution model implemented: 3,174 inactive state accounts since 2017, amounting to R$222 million.

b. **Limited control of information on liabilities**[28] due to: (i) weak control, accounting, and payment terms for court proceedings (settlements, court-ordered payments, and small value requisitions (RPV)) and judicial deposit records; and (ii) manual entry in multiple databases, giving rise to the possibility of transcription errors and generating late or duplicate payments.

c. **Inefficient concession contract management**[29] due to: (i) concession management not based on methodologies; (ii) the lack of a management system for Associations of Public Interest Civil Societies (OSCIP) and social organizations; and (iii) limited capacity to manage decentralized units.

d. **Accounting systems are still not duly adapted to Brazilian Accounting Standards**[30,31] due to: (i) discrepancies in accounting records between FIPLAN and private accounting systems; (ii) poor revenue and expenditure control between state bodies; (iii) asset systems not integrated into FIPLAN; and (iv) nontax claim management systems not integrated into FIPLAN.

e. **Limited control in public debt management**[32] due to: (i) the lack of a sustainability analysis; (ii) manual control of debt-related budget and financial execution; (iii) the hard copy-only format of contracts and documents; (iv) unstructured procedures not based on manuals; and (v) exchange auctions carried out solely by phone.

f. **Public costs**[33] cannot be calculated due to the inefficiency of the Government Costing Information System, which does not calculate the costs of activities or services provided by the government, and the lack of an adequate management methodology and system.

1.19 **The Bank's experience in the country.** The Bank has supported various operations to improve fiscal management in Brazil, particularly at the state level, under the National Fiscal Administration Program for the Brazilian States (PNAFE 980/OC-BR) and the PROFISCO I CCLIP (BR-X1005). It also supported the Fiscal Modernization Project in the State of São Paulo (4460/OC-BR), the Program to Support Fiscal Management Modernization and Transparency in the State of Bahia (1727/OC-BR), and fiscal stability consolidation projects in the states of Amazonas, Alagoas, Bahia, Pernambuco, and Rio Grande do Sul.[34] At other government levels, it supported the Fiscal Modernization Project of the

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28 Technical note - Evidence of RPV and preventive management: Evidence from the Bahia State Audit Office (TCE/BA) regarding RPV payment delays.

29 Technical note - Management system for contracts with concession holders, social organizations, and OSCIPs: A total of 40 contracts with OSCIPs, 30 contracts with social organizations, and 15 concession contracts without control or monitoring.

30 Brazilian Accounting Standards - Public-sector transactions.

31 The 2018 TCE/BA report indicated differences between accounting and asset records contained in FIPLAN and in the systems of state-owned enterprises.

32 Technical note - Public debt management model implemented: Debt management through electronic templates; TCE/BA comments.

33 Technical note - Public cost optimization model: Failure to identify costs impedes the evaluation of public administration results and performance target setting.

34 Policy-based programs: loans 2081/OC-BR; 2841/OC-BR; 2850/OC-BR; 3039/OC-BR; 3061/OC-BR; 3138/OC-BR; and 3139/OC-BR.

Federal Revenue Service (SRF, 1996) and the Administrative and Fiscal Management Modernization Program for Municipalities (PNAFM I / 1194/OC-BR, II / 2248/OC-BR, and III / 3391/OC-BR). The following operations were already approved under the PROFISCO II CCLIP (BR-X1039): Piauí (4460/OC-BR); Maranhão (4458/OC-BR); Ceará (4436/OC-BR); Pará (4459/OC-BR); Pernambuco (4554/OC-BR); Mato Grosso do Sul (4597/OC-BR); São Paulo (4706/OC-BR); and Espírito Santo (4741/OC-BR).

1.20 The midterm evaluation of the PROFISCO I CCLIP found that, between 2009 and 2013, states with a PROFISCO at an advanced stage of execution collected on average 6% more in ICMS revenue than states with a PROFISCO in the early stages.

1.21 The PROFISCO I-BA project completion report (PCR)[35] indicated that the project was a success (Relevance–excellent; Effectiveness–excellent; Efficiency–satisfactory; and Sustainability–satisfactory). Of the five outcome targets planned, five (100%) were fully met in relation to tax revenue, the oversight model implemented based on SPED information (US$920,800)[36] using the Census Tax Net and Online Tax Domicile System, the new goods-in-transit oversight model (US$78,000), with the integration of vehicle and goods information from Brasil-ID into SEFAZ/BA systems, and the implementation of the Consumer Electronic Tax Invoice (US$416,000). All these interventions contributed more directly to the increase in the state's tax revenue collection. With respect to the improvement of the financial administration, the distance learning program (US$1.4 million), which reduced the cost of fiscal management training, and the implementation of new FIPLAN functionalities (US$3.8 million) contributed to more effective budget, financial, and accounting management, with greater security in work processes and better reporting quality. Executing agency and Bank performance was classified as satisfactory. In terms of tax administration, PROFISCO II-BA actions will focus on further enhancing policy development and claim management and collection, facilitating the fulfillment of obligations by taxpayers, and increasing the use of new technologies for electronic oversight.

1.22 **Lessons learned.** The lessons learned from the PROFISCO I CCLIP and PROFISCO I-BA (2914/OC-BR) are as follows:

a. **Design.** An instrument is needed to identify innovative solutions in fiscal management processes. The MD-GEFIS, which identifies the maturity of state fiscal management processes and opportunities for strengthening them, was therefore developed.[37]

b. **Development.** Participation by SEFAZ/BA in the Treasury Management Commission Network led to the exchange of experiences and solutions in fiscal management modernization from other states.

[35] The final disbursement date specified in the contract is 17 December 2019.

[36] US$873,000 of the institutional oversight model and US$52,000 of the online tax domicile.

[37] CIAT, 2017.

c. **Execution.** To compensate for delays in execution, the Bank created a monitoring tool called the "Implementation Acceleration Plan," which identifies, through the progress monitoring report, outputs with implementation delays and prepares mitigation measures until implementation is back on track.

d. **Outcomes.** It was found that SPED, including the electronic tax invoice, digital tax record, and digital accounting record, were the outputs that contributed most to increasing the efficiency of fiscal oversight in the states.[38] This operation will make a major investment in SPED's development and seek to maximize its potential by expanding the use of the information it generates to automate tax auditing,[39] simplifying tax obligations, including by leveraging new digital economy technologies.

e. **PROFISCO I-BA**, in particular the PCR, identified the following factors as having a negative impact on project execution: (i) difficulty developing the terms of reference; (ii) difficulty implementing a large number of outputs; and (iii) procurement delays. This project includes actions to: (i) maintain the structure and staff of the project coordination unit (PCU) that executed PROFISCO I, with additional measures to improve coordination between project leaders responsible for outputs and to provide them with training on project management and Bank policies; (ii) hire consultants to help with the technical specifications and preparation of the terms of reference; (iii) adopt project management tools; and (iv) reduce the number of outputs and consolidate procurement processes.

1.23 **The Bank's experience in the region's other countries.** Recent Bank experience with tax administration reform in Costa Rica (4819/OC-CR), Ecuador (3325/OC-EC), El Salvador (3852/OC-ES), Honduras (3541/BL-HO), Jamaica (2658/OC-JA), and Peru (3214/OC-PE); modernization of financial management systems in Guyana (1550/SF-GY and 1551/SF-GY), Honduras (2032/BL-HO), and Nicaragua (2422/BL-NI); and public investment management in Argentina (3835/OC-AR), Bolivia (3534/BL-BO), Chile (1281/OC-CH), Ecuador (2585/OC-EC), Mexico (2550/OC-ME), Paraguay (3628/OC-PR), Panama (2568/OC-PN), and Peru (2703/OC-PE) were considered in this operation and emphasize the role of the institutional strengthening of fiscal management. Some of the lessons learned, which are in line with international evidence, are detailed below.

1.24 Tax collection performance is highly dependent on the institutional strengthening of tax administrations in terms of their organizational structure, processes, and support tools: (i) improving access to and the quality of available information;[40] (ii) implementing oversight models based on intensive information use;[41]

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38 McKinsey & Company, 2014: The electronic tax invoice and SPED increased the risk of tax evaders being identified and helped reduce informal employment in Brazil over the past ten years (from 55% to 40%).

39 Araujo, 2013: The use of SPED, associated with artificial intelligence, will increase the likelihood of identifying tax fraud.

40 Slemrod et al. (2015); Pomeranz (2015); and Kleven et al. (2011).

41 Almunia and López Rodriguez (2016).

(iii) simplifying procedures to facilitate tax compliance;[42] and (iv) defining strategies to ensure the suitability and motivation of human resources.[43] Various Latin American tax administrations have strengthened these elements, particularly Brazil and Uruguay.[44] The available evidence on strengthening financial management shows that automation does not produce the expected outcomes unless institutional processes are improved.[45] With respect to expenditure efficiency and effectiveness, various studies show the need to establish an expenditure management system with a multiyear perspective for budget development, such as the Medium-term Budget Framework.[46] Countries with a sound Medium-term Budget Framework tend to be more effective in meeting their fiscal targets.[47]

1.25 **Strategic alignment.** The project is consistent with the Update to the Institutional Strategy 2010-2020 (document AB-3008) and is aligned with the development challenge of productivity and innovation, by reducing the cost of collection through the use of information and digital technologies, and with the crosscutting area of institutional capacity and rule of law, by strengthening tax systems and the management and planning of public resources. The project contributes to the Corporate Results Framework 2016-2019 (document GN-2727-6) via the indicators for: (i) percent of GDP collected in taxes; (ii) government agencies benefited by projects that strengthen technological and managerial tools to improve public service delivery by strengthening the Tax Management System and the Integrated Financial Management System; (iii) subnational governments benefited by decentralization, fiscal management, and institutional capacity projects; (iv) countries that use national fiduciary systems; and (v) institutions with strengthened accountability. It is also aligned with the Sector Strategy on Institutions for Growth and Social Welfare (document GN-2587-2) and is consistent with the Decentralization and Subnational Governments Sector Framework Document (document GN-2813-8) and the Fiscal Policy and Management Sector Framework Document (document GN-2831-8) in the following areas: (i) improving the efficiency and quality of expenditure and service delivery; (ii) improving tax collection; and (iii) promoting greater transparency and accountability.

1.26 **The Bank's strategy with the country.** The project is aligned with the IDB Group Country Strategy with Brazil 2019-2022 (document GN-2973) through the following strategic objectives: (i) reform the structure of public expenditure (Components 1 and 3); (ii) improve the public investment system (Component 3); and (iii) promote e-government and digital solutions to promote transparency and accountability (Component 1) as well as efficiency in delivering public services to citizens and enterprises (Component 2). The project is also aligned with the crosscutting theme of innovation and digital transformation (Components 2 and 3). Lastly, the operation is included in the Update of the Annex III of the 2019 Operational Program Report (document GN-2948-2).

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42 Hallsworth et al. (2014).

43 Khan et al. (2016).

44 PCR for 1783/OC-UR. Barreix and Zambrano (2018).

45 PCR for 1550/SF-GY and 1551/SF-GY.

46 World Bank (2013 and 1998).

47 IMF, 2013 and World Bank, 2013.

B. Objectives, components, and cost

1.27 The project objective is to contribute to the fiscal sustainability of the state of Bahia through: (i) the modernization of fiscal management; (ii) the upgrading of the tax administration; and (iii) better public expenditure management. The project will finance the following components:

1.28 **Component 1. Financial management and fiscal transparency (US$23,048,000).** This component aims to improve management instruments, modernize the technology infrastructure, and increase the tax authority's transparency with society, enhancing the institutional performance of SEFAZ/BA. It will finance the implementation of:

a. **Public governance and managing for results model (US$1,320,250),**[48] including: (i) strategic planning of fiscal management incorporated into the state's strategic planning; (ii) the project office; (iii) the change management plan; and (iv) a project and process management system.

b. **Professional development model (US$3,560,500),**[49] including: (i) knowledge management program; (ii) training program; (iii) performance evaluation program; and (iv) exchange of experiences and technical cooperation.

c. **IT management model (US$15,948,500),**[50] including: (i) PDTI (ii) Big Data solution; (iii) Operations Security Center; and (iv) expansion of storage and processing capacity.

d. **Public procurement model (US$1,686,000),** including: (i) process mapping and review; (ii) strategic state procurement plan; (iii) public procurement management system; and (iv) integrated material, asset, and services system.

e. **Internal control and transparency model (US$532,750),** including: (i) transparency portal; (ii) integrity and risk management program; (iii) internal control portal; and (iv) operational audits.

1.29 **Component 2. Tax administration and litigation (US$13,998,500).** This component seeks to increase the efficiency of tax revenue collection, increase revenues, and simplify tax compliance. It will finance the implementation of:

a. **Tax policy management model (US$330,000),** including: (i) tax benefit management system modules; (ii) cumulative tax claim management system; and (iii) economic scenario and tax gap estimation modeling.

b. **Simplified tax obligation compliance model (US$562,500),** including: (i) REDESIM implementation; (ii) simplification of compliance with ancillary obligations related to the ICMS by means of the elimination of certain monthly

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48 The amounts for outputs are indicative.

49 The model will take into account the effect that new technologies will have on data management in the SEFAZ/BA staff structure and on training models.

50 The governance and IT management model and the information security plan will specify the responsibilities and resources for maintaining and updating the IT infrastructure and information security actions, respectively.

returns required by taxpayers; and (iii) import control module integrated into the Unified Foreign Trade Portal.

c. **Information management model (US$1,566,000),** including: (i) information management and structuring strategy, in the context of Big Data; (ii) data science methodology; (iii) modules for the production of information in data warehouses; and (iv) system for the availability of electronic tax documents for taxpayers.

d. **Oversight model (US$2,800,000),** through: (i) real-time monitoring systems for oversight of goods in transit; (ii) oversight planning and control module integrated into e-oversight; (iii) indicator-based oversight modules (census tax net); (iv) tax rule automation system; and (v) oversight tools.

e. **Model for the adjudication of tax litigation cases (US$577,500),** including: (i) artificial intelligence tools for jurisprudence research and vote preparation; (iii) online adjudication assistance tool; (iv) tax litigation management system; and (v) smartphone app.

f. **Taxpayer services model (US$7,187,500),** including: (i) implementation of services for citizens that can be completed online from start to finish; (ii) communication channels; and (iii) reclassification of tax administration and taxpayer services units.

g. **Tax management model (US$975,000),** including: (i) process mapping and review; (ii) online tax administration process integration module;[51] (iii) IPVA and inheritance and gifts tax control systems; and (iv) enforcement system.

1.30 **Component 3. Financial management and public expenditure (US$6,245,250).** This component aims to contribute to fiscal discipline and to an increase in public expenditure efficiency and effectiveness. It will finance the implementation of:

a. **Financial execution model (US$3,747,000),** including: (i) process mapping and review; (ii) econometric modeling for scenario development; (iii) new FIPLAN functionalities, including bank reconciliation, cash flow, and delay alerts; and (iv) integration of Bahia's human resource payroll system into FIPLAN.

b. **Small claim and court-ordered payment management system (US$225,000),**[52] including: (i) process mapping and redesign; and (ii) modules for the integration of the court ordered payment and RPV management system into FIPLAN and into the systems of the Office of the State Attorney General (PGE).

c. **Concession contract management system (US$407,750),** including: (i) review of governance processes; (ii) methodology for managing public-private partnerships, concessions, social organizations, and OSCIPs; (iii) social organization and OSCIP management system; and (iv) training.

d. **Accounting management model (US$887,500),** including: (i) methodology for matching accounting records between FIPLAN and private accounting;

[51] Online tax administration process.

[52] RPV.

(ii) system for revenue and expenditure control between state bodies; (iii) FIPLAN integration with asset, consumer goods, and personal and real property systems; and (iv) FIPLAN integration into the Nontax Claim System.

e. **Public debt management model (US$340,500),** including: (i) debt sustainability analysis methodology; (ii) debt management system integration into FIPLAN; (iii) exchange auction module; and (iv) contract rule control and simulation module.

f. **Public cost optimization model (US$637,500),**[53] including: (i) calculation methodology; (ii) system; (iii) public expenditure portal; and (iv) training.

1.31 The project will finance consulting services in the amount of US$18,503,000; nonconsulting services in the amount of US$1,576,500; goods in the amount of US$16,215,000; training in the amount of US$1,197,250; and works[54] in the amount of US$5,800,000.

1.32 The project management cost is estimated to be US$1,208,250 and includes PCU support activities, monitoring, and evaluation, totaling US$190,000.

1.33 **Beneficiaries.** By enhancing public finance performance, increasing tax revenue collection, and improving public expenditure efficiency, the state's greater fiscal sustainability will benefit its citizens, enterprises, and individual taxpayers as well as entities in the public and nongovernment sectors through better service delivery, facilities and lower costs for tax compliance, and greater availability of information and data for public management and the transparency of public accounts.

C. Key results indicators

1.34 The expected impacts are: (i) a decline in the primary fiscal deficit as a percentage of GDP; (ii) an increase in tax collection as a percentage of GDP; and (iii) a decrease in net current debt as a percentage of GDP. The expected outcomes are: (i) an increase in the ratio of strategic planning targets met to total planned targets; (ii) a decrease in the ratio between the collection cost and the tax revenue collected; (iii) a narrowing of the gap between the budget as planned and as executed.

1.35 **Cost-effectiveness analysis.** An economic analysis of the project's economic/financial costs and benefits yielded the following results: (i) increase in tax revenue collection through the adoption of a new IPVA control system and the new collection model; (ii) savings in resources due to process automation, which will reduce the time that auditors and tax agents currently spend carrying out activities manually; and (iii) reduction of costs for taxpayers by eliminating three ancillary obligations and improving online service delivery. By the end of 2029 (10 years), the project's investments will have a net present value of US$15.6 million with an internal rate of return (IRR) of 36%.[55] The sensitivity

[53] PROFISCO I financed training, seminars, technical visits, and contracting of consultants. Outputs finalized in 2013: (i) conceptual cost system model; (ii) definition of the technological support solution; and (iii) training.

[54] Adaptation of spaces, small renovations, and remodeling of facilities at SEFAZ/BA headquarters (US$2.4 million) and fiscal inspection stations (US$3.4 million) in various state localities.

[55] Base case scenario, not including the increase in revenue collection.

analysis produced robust results and includes three different scenarios: a 30% devaluation of the Brazilian currency (IRR of 34.89%), a 25% reduction in all benefits (IRR of 31.64%), and a scenario that combines devaluation and a reduction in benefits (IRR of 16.71%).

II. FINANCING STRUCTURE AND MAIN RISKS

A. Financing instruments

2.1 This operation was designed as a specific investment loan under the PROFISCO II CCLIP (BR-X1039) and has a total estimated cost of US$44.5 million, to be financed with an investment loan from the Bank's Ordinary Capital in the amount of US$40 million (90% of the project cost) and a local counterpart contribution in the amount of US$4.5 million (10% of the total project cost). The distribution of resources by financing source and category is shown in the table below:

Table 1. Total budget (in U.S. dollars)

Category	IDB	Local	Total	%
A. Direct costs	**38,791,750**	**4,500,000**	**43,291,750**	**97.28**
Component 1. Financial management and fiscal transparency	23,048,000	-	23,048,000	51.79
Component 2. Tax administration and litigation	12,873,500	1,125,000	13,998,500	31.46
Component 3. Financial management and public expenditure	2,870,250	3,375,000	6,245,250	14.03
B. Project management	**1,208,250**	**-**	**1,208,250**	**2.72**
PCU	1,018,250	-	1,018,250	2.29
Monitoring and evaluation	190,000	-	190,000	0.43
Total	**40,000,000**	**4,500,000**	**44,500,000**	**100**

2.2 **Disbursement schedule.** Disbursements will be made over a five-year period as shown in Table 2 below.

Table 2. Disbursement schedule (in U.S. dollars)

Source	Year 1	Year 2	Year 3	Year 4	Year 5	Total
IDB	1,521,546	10,489,739	10,985,850	11,679,571	5,323,294	40,000,000
Local	421,650	891,600	910,500	1,029,300	1,246,950	4,500,000
Total	**1,943,196**	**11,381,339**	**11,896,350**	**12,708,871**	**6,570,244**	**44,500,000**
%	**4.4**	**25.6**	**26.7**	**28.5**	**14.8**	**100%**

2.3 **Fulfillment of the eligibility conditions to participate in the PROFISCO II CCLIP (BR-X1039).** This project is the twelfth individual loan operation under the PROFISCO II CCLIP (BR-X1039) approved by the Board of Executive Directors under Resolution DE-113/17. The project complies with the eligibility criteria envisaged in the policy applicable to CCLIPs (document GN-2246-9)[56] for individual loan operations, given that: (i) it belongs to the fiscal sector and is compatible with all components of the PROFISCO II CCLIP; (ii) it is included in the Update to Annex III of the 2019 Operational Program Report (document GN-2948-2); (iii) the State will execute the operation through SEFAZ/BA, which was the executing agency of the first individual operation under the PROFISCO I CCLIP (2914/OC-BR); (iv) the State satisfactorily executed the PROFISCO I-BA project, achieving the planned objectives; and (v) the findings of the institutional analysis show that SEFAZ/BA's capabilities have not deteriorated, the same project execution and monitoring tools can be used for this new operation, and PCU staff will be the same. In accordance with the PCR for loan 2914/OC-BR: (i) the project objectives were satisfactorily achieved; and (ii) the project execution unit fulfilled the contractual requirements and Bank disbursement policies, and its accounts were audited and meet the required quality standards.

B. Environmental and social risks

2.4 In accordance with the Bank's Environment and Safeguards Compliance Policy (Operational Policy OP-703), Directive B.3, this project is classified as a Category "C" operation. As the project entails only the remodeling of internal spaces, socioenvironmental risks are not anticipated.

C. Fiduciary risks

2.5 A medium-high fiduciary risk was identified to the effect that if SEFAZ/BA does not have a procurement processing flow, delays may arise in goods and services procurement processes. This risk will be mitigated through the coordinated approval of the procurement plan by SEFAZ/BA and the Administration Department and through the adoption of a procurement processing flow.

D. Other key issues and risks

2.6 A risk management workshop was held based on the Bank's methodology, and the operation was rated as posing a medium risk. These risks are:

a. **Public management and governance (medium-high and high).** The following was classified as a medium-high risk: if the project leaders responsible for outputs change, the loss of knowledge can lead to project execution delays. This risk is expected to be mitigated through the implementation of the knowledge management plan (paragraph 1.28b) and team qualification. The following was classified as a high risk: if SEFAZ/BA does not have an appropriate output and project management structure, it may not meet the project scope, cost, time, and quality requirements, causing implementation delays and a failure to fulfill objectives. This risk is expected to be mitigated through: (i) training for project leaders responsible for outputs (paragraph 1.28b); (ii) implementation of a strategic management committee; and (iii) implementation of a project management office (paragraph 1.28b).

b. **Development (medium-high and high).** The following was classified as a medium-high risk: if IT staff does not have adequate human resources and

[56] This operation was prepared in accordance with the eligibility criteria established in document GN-2246-9, as established in paragraph 3.12 of document GN-2246-13.

management methodologies, it may not meet the development and support demand for project outputs, which could delay program implementation and prevent it from meeting its objectives. This risk is expected to be mitigated through: (i) the assignment of 17 new employees to the IT department based on a competitive process held in 2019, which will triple the current number of staff; (ii) the contracting of the Bahia data processing company PRODEB to develop systems in the finance area; and (iii) the development and implementation of the PDTI, with a review of the development, contract, and service management models (paragraph 1.28c). The following was classified as a high risk: if there is no prioritization in procurement and it becomes necessary, by decision of a superior authority, to submit the bidding processes to the Administration Department of the State of Bahia (SAEB) (quality control) (paragraphs 3.3 and 3.5) and to SEFAZ/BA (public expenditure), delays of up to three months could arise in bidding processes, which would delay project execution. This risk is expected to be mitigated through the prior approval of the project procurement plan by the Secretaries of Finance and SAEB.

2.7 **Financial analysis.** The analysis of Bahia's financial position confirms its payment capacity to service the debt contracted, which accounted for 0.005% of the state's GDP in 2016 and 0.04% of net current income in 2018. The state's payment capacity is classified as category "C"[57] in accordance with the National Revenue Service payment capacity methodology. The payment capacity calculation methodology considers three indicators: (i) debt (gross consolidated debt/net current income) – Bahia's rarting is B; (ii) current savings (current expenditure/current income) – Bahia's rating is C; and (iii) liquidity ratio (short-term financial obligations/cash on hand) – Bahia's rating is C. The rating assigned ranges from A, excellent fiscal position, to D, poor fiscal position. Only states whose payment capacity is classified as "A" and "B" are authorized to contract credit operations with the sovereign guarantee. Moreover, Bahia is in compliance with the determinants of the Fiscal Responsibility Law and the conditions of the Fiscal Adjustment and Restructuring Program for Bahia (STN, 2019).

2.8 **Project sustainability.** In addition to the measures already being taken by the government (paragraph 2.6), the project includes measures conducive to fiscal sustainability in the medium and long term, such as expenditure control[58] and the reduction of tax evasion,[59] which will lead to higher revenues. To ensure that the capacities generated by the project are sustainable once project execution is finished, PROFISCO II-BA includes actions for increasing revenues by improving fiscal action, oversight of taxpayers and goods in transit, and tax claim recovery. The associated outputs are: tax policy management model; oversight model; revenue, tax claim, and collection management model; model for the adjudication of tax litigation cases; and public cost optimization model (project economic

[57] Although the federal government does not guarantee the loan operations of subnational entities with a "C" and "D" payment capacity, the PROFISCO II CCLIP received exceptional treatment to allow states to have external credit operations with sovereign guarantee, regardless of the payment capacity classification, bearing in mind that CCLIP projects are aimed at improving revenues and fiscal, financial, and asset management.

[58] For example, with the output referred to in the public cost optimization model.

[59] Component 2 outputs.

analysis). With respect to IT investments, SEFAZ/BA will use mainly its permanent staff, PRODEB, and support consultants for in-house development. In addition, the project will finance the PDTI and the information security system, which includes SEFAZ/BA's adaptation to the General Personal Data Protection Law (Law 13,709) and the contracting of an Operations Security Center, in addition to specifying the responsibilities and resources for maintaining and updating the IT infrastructure and information security actions.

III. IMPLEMENTATION AND MANAGEMENT PLAN

A. Summary of implementation arrangements

3.1 The borrower will be the State of Bahia, which will execute the operation through SEFAZ/BA. The Federative Republic of Brazil will be the guarantor for the borrower's financial obligations, in accordance with the policy on Guarantees Required from the Borrower (document GP-104-2). SEFAZ/BA will establish a PCU, which will have a general coordinator, a financial coordinator, a procurement coordinator, and a planning and monitoring coordinator. The PCU will coordinate monitoring, evaluation, and auditing activities with the aim of overseeing project execution and the achievement of operation's objectives. The PCU members will be civil servants of the State of Bahia. Long-term contracting of consultants for managerial tasks is not expected for this project.

3.2 The PCU's main functions will be to: (i) plan the execution of activities; (ii) implement and update the project's operational tools, namely the multiyear execution plan, the annual work plan, and the procurement plan; (iii) supervise execution and submit reports, namely the multiyear execution plan, annual work plan, procurement plan, and progress monitoring report; (iv) provide support in preparing terms of reference, procuring goods, and selecting and contracting services; (v) submit justifications and disbursement requests to the Bank; (vi) prepare financial statements; and (vii) submit the project evaluation. The borrower will adhere to the program Operating Regulations approved by the Bank for the PROFISCO II CCLIP, which establish: (i) the eligibility criteria for projects and outputs subject to financing; (ii) project execution roles, procedures, and rules; and (iii) operational and contractual relationships between the parties involved in the project.

3.3 **Interagency coordination mechanisms.** SEFAZ/BA will work jointly with the SAEB and PGE in carrying out activities benefiting the latter institutions. These institutions will appoint project leaders responsible for the corresponding outputs, who will coordinate their actions with the PCU and will ensure their technical development and implementation. To coordinate these State material and procurement management and tax litigation activities, in particular as concerns procurement, information flows and processes between beneficiaries, the PCU, and the Special Bidding Committee will be mapped and defined, clarifying roles, responsibilities, and timelines. This will be implemented through cooperation instruments (paragraph 3.5).[60]

[60] Model technical cooperation agreement.

3.4 **Special contractual conditions precedent to the first disbursement of the loan: (i) the borrower's adherence to the program Operating Regulations, previously approved by the Bank for all individual operations under the PROFISCO II CCLIP; and (ii) creation of the PCU and appointment of its members.** These conditions are essential to ensure that the executing agency has detailed regulations in place on operational and fiduciary matters and to mitigate the risk of delays in project execution. This practice was adopted under PROFISCO I and proved successful, as it made it possible to consolidate, in the program Operating Regulations, the themes of coordination and guidance relevant to the executing agencies and to guarantee the more efficient distribution of responsibilities among PCU members in the technical, financial, procurement, and monitoring and planning areas.[61]

3.5 **Special contractual condition for execution.** Before starting to execute activities that have outputs geared toward the SAEB or PGE, SEFAZ/BA will sign cooperation agreements with the respective entities to establish the roles and responsibilities of the parties during execution. Activities will be coordinated with: (i) SAEB, in relation to public procurement management and the implementation of the integrated material, asset, and service system under Component 1; and (ii) PGE, in relation to the management of tax litigation cases, provided for under Component 2. This condition was successfully adopted under PROFISCO I and helped identify the specific responsibilities of each body, given the implementation of the outputs provided for in the components. The adoption of this practice is again justified to guarantee the mechanism for coordination between the agencies, as they are entities independent of SEFAZ/BA, and to mitigate the risk of output delays during execution (paragraph 2.6b).

3.6 **Procurement.** Project procurement and contracting will comply with the Policies for the Procurement of Goods and Works financed by the Inter-American Development Bank (document GN-2349-9) and the Policies for the Selection and Contracting of Consultants financed by the Inter-American Development Bank (document GN-2350-9), and the provisions of the procurement plan.

3.7 **Single-source selection.** In accordance with the policies set forth in documents GN-2349-9 and GN-2350-9, the following entities will be subject to single-source selection: (i) the National School of Public Administration of the Ministry of Economy, state government schools, federal and state universities, and data processing companies, and, in the specific case of this project, PRODEB,[62] which provide training to civil servants as well as technical assistance in IT development; and (ii) analysis, research, and assistance for IT buyers by *Gartner do Brasil Serviços de Pesquisas Ltda*.[63] This single-source selection is justified because federal and state entities are dedicated to training civil servants owing to their unique and exceptional nature as the hub for the government's IT education,

61 PROFISCO I PCU, 2015.

62 Paragraphs 3.6(b) and (c) of document GN-2349-9, due to the need to standardize the software developed and the unique technical characteristics. PRODEB implemented the state's FIPLAN and will implement the new FIPLAN functionalities proposed as part of the project.

63 Paragraphs 3.10 and 3.11 of document GN-2350-9, due to the continuity in the provision of its services and the exceptional experience and qualifications.

research, and development; Gartner is already carrying out these activities successfully (see Annex III, paragraphs 4.4 to 4.5).

3.8 **Audited financial statements.** The borrower will submit audited financial statements to the Bank annually, within 120 days following the close of each fiscal year. The external audit will be performed by the TCE/BA.[64] The audit of the entire project will be contracted by SEFAZ/BA, the terms of reference of which will have the Bank's no objection.

3.9 **Rationale for advances.** SAF/SEFAZ Regulation 18 establishes the release of the financial programming quotas of its administration units only where financial resources are available, meaning that new hires are only possible when the corresponding financial balance is available. In that regard, based on paragraph 3.3(i) of the Financial Management Guidelines for IDB-financed Projects (document OP-273-12), at least 50% of the advanced amount will be required for accountability reporting purposes.

B. Summary of arrangements for monitoring results

3.10 **Monitoring.** Monitoring will be based on: (i) the multiyear execution plan and annual work plan; (ii) the procurement plan; (iii) the Results Matrix; (iv) the monitoring and evaluation plan; and (v) the project monitoring report. The PCU will prepare semiannual reports on progress in meeting the outcome, output, and financial targets for approval by the Bank, which will conduct inspection visits and ex post reviews as part of project monitoring.

3.11 **Evaluation.** The project will be evaluated against the annual targets and indicators for the impacts and outcomes defined in the project Results Matrix on the basis of a before and after comparison. The monitoring and evaluation plan includes an independent midterm evaluation to be conducted 36 months after the effective date of the loan contract, or once 50% of the project funds have been disbursed, whichever occurs first, and a final evaluation to be conducted 90 days after the date of the last disbursement of funds. The evaluation reports will serve as input for the project completion report.

[64] The TCE/BA and the Bank signed a memorandum of understanding to audit state loan and technical cooperation contracts.

Development Effectiveness Matrix		
Summary	**BR-L1533**	
I. Corporate and Country Priorities		
1. IDB Development Objectives		
Development Challenges & Cross-cutting Themes	-Productivity and Innovation -Institutional Capacity and the Rule of Law	
Country Development Results Indicators	-Percent of GDP collected in taxes (%) -Government agencies benefited by projects that strengthen technological and managerial tools to improve public service delivery (#)* -Subnational governments benefited by decentralization, fiscal management and institutional capacity projects (#)* -Countries that use fiduciary country systems (#)* -Accountability institutions strengthened (#)*	
2. Country Development Objectives		
Country Strategy Results Matrix	GN-2973	(i) reform the structure of public expenditure; (ii) perfect the public investment system; and (iii) promote e-government and digital solutions to foster transparency, accountability, and efficiency in delivering public services to citizens and enterprises.
Country Program Results Matrix	GN-2948-2	The intervention is included in the 2019 Operational Program.
Relevance of this project to country development challenges (If not aligned to country strategy or country program)		
II. Development Outcomes - Evaluability		Evaluable
3. Evidence-based Assessment & Solution	10.0	
3.1 Program Diagnosis	3.0	
3.2 Proposed Interventions or Solutions	4.0	
3.3 Results Matrix Quality	3.0	
4. Ex ante Economic Analysis	9.0	
4.1 Program has an ERR/NPV, or key outcomes identified for CEA	3.0	
4.2 Identified and Quantified Benefits and Costs	3.0	
4.3 Reasonable Assumptions	1.0	
4.4 Sensitivity Analysis	2.0	
4.5 Consistency with results matrix	0.0	
5. Monitoring and Evaluation	10.0	
5.1 Monitoring Mechanisms	2.5	
5.2 Evaluation Plan	7.5	
III. Risks & Mitigation Monitoring Matrix		
Overall risks rate = magnitude of risks*likelihood	Medium	
Identified risks have been rated for magnitude and likelihood	Yes	
Mitigation measures have been identified for major risks	Yes	
Mitigation measures have indicators for tracking their implementation	Yes	
Environmental & social risk classification	C	
IV. IDB´s Role - Additionality		
The project relies on the use of country systems		
Fiduciary (VPC/FMP Criteria)	Yes	Financial Management: Budget, Treasury, Accounting and Reporting, External Control, Internal Audit. Procurement: Information System, Price Comparison, Contracting Individual Consultant.
Non-Fiduciary	Yes	Strategic Planning National System, Statistics National System, Environmental Assessment National System.
The IDB's involvement promotes additional improvements of the intended beneficiaries and/or public sector entity in the following dimensions:		
Additional (to project preparation) technical assistance was provided to the public sector entity prior to approval to increase the likelihood of success of the project	Yes	The IDB team developed and applied a methodology (MD-GEFIS) to assess the state of public finances and fiscal mangement processes in the State of Bahia to design the project and to monitor future performance against the baseline.

Note: (*) Indicates contribution to the corresponding CRF's Country Development Results Indicator.

Evaluability Assessment Note:

The main goal of the operation is to contribute to the fiscal sustainability of the State of Bahia. To achieve this end, the proposal defines three specific areas on which the project will intervene. The first area is fiscal management. The second area is tax administration. The third area is the administration of public expenditure. Each of these areas is associated to a component. The document includes a description of the process gaps that lead to weaknesses in each of these three areas. The project is the child of a series of operations under the Conditional Credit Line for Investment Projects (CCLIP) parent BR-X1039.

The project proposal diagnoses a primary balance as a share of the State PIB of -0.01 percent and a Current Net Debt as a share of the State PIB of 7.14 Percent in 2018 (SEFAZ, 2018). The diagnosis is based on the MD-GEFIS tool which analyzes processes in the three main areas which define the components. The Ministry of Finance provides a diagnosis for a total of 21 sub areas. Each diagnosis identified the main restrictions for the Ministry to increase tax revenue, decrease running costs or improve efficiency in expenditures, and improve service delivery to citizens. Overall, the diagnosis identifies gaps in institutional arrangements (such as weak coordination and outdated legal documents), deficits in personnel management and training, and gaps in capital investments (resulting in outdated technological infrastructure, limited availability of information, and lack of mechanisms to communicate with citizens). The quantification of these needs is disaggregated for 18 processes.

The economic analysis provides a quantification of savings to the State through technological tools which allow for efficiency gains. The quantification of benefits is associated to savings by citizens to file taxes. The costs include investment in technology and fund for its operation. The analysis concludes with a net present value of US$16 million.

Monitoring relies on reports by the Finance Secretariat of the State. The ex post evaluation plan includes an impact evaluation to identify the effects of automatizing the detection of irregularities and notifying taxpayers on tax evasion. The evaluation relies on a randomized control trial.

The project identifies eight risks with two labeled as high, four as medium, and two as low. The risks classified as high are an appropriate management of outputs and delays in procurement processes causing delays and threatening the achievement of objectives.

RESULTS MATRIX

Project objective:	The project objective is to contribute to the fiscal sustainability of the State of Bahia through: (i) the modernization of financial management; (ii) the upgrading of the tax administration; and (iii) better public expenditure management.

EXPECTED IMPACTS

Indicators	Unit of measure	Baseline	Baseline year	Year 1	Year 2	Year 3	Year 4	Year 5	Final target	Target year	Means of verification	Comments
IMPACT 1: A decrease in the ratio of primary fiscal deficit to Bahia's GDP												
Primary balance/ Bahia's GDP	%	-0.01	2018	0.14	0.14	0.15	0.16	0.16	0.16	2024	SEFAZ/BA Treasury report	See monitoring and evaluation plan
IMPACT 2: An increase in the ratio of tax revenue to Bahia's GDP												
Tax revenue/ Bahia's GDP	%	8.65	2018	9.12	9.12	9.12	8.95	8.78	8.78	2024	SEFAZ/BA Tax Administration report	See monitoring and evaluation plan
IMPACT 3: A decrease in the ratio of net current debt to Bahia's GDP												
Net current debt/[1] Bahia's GDP	%	7.14	2018	7.56	6.91	4.82	4.01	3.17	3.17	2024	SEFAZ/BA Treasury report	See monitoring and evaluation plan

[1] Represents the consolidated debt amount less the balance of financial assets (cash and other financial assets). National Treasury Department.

EXPECTED OUTCOMES[2]

Outcome indicator	Unit of measure	Baseline	Baseline year	Year 1	Year 2	Year 3	Year 4	Year 5	Final target	Target year	Means of verification	Comments
OUTCOME 1: An increase in the ratio of strategic planning targets met to total planned targets												
Targets met/total planned targets	%	0	2018	0	15.0	30.0	45.0	60.0	60.0	2024	SEFAZ/BA action plan dashboard	See monitoring and evaluation plan
OUTCOME 2: A decrease in the ratio of cost of tax collection to tax revenue												
SEFA operating budget/total tax revenue	%	3.17	2018	2.97	2.85	2.73	2.66	2.71	2.71	2024	Bahia-SEFAZ/BA balance sheet and SEFAZ financial report	See monitoring and evaluation plan
OUTCOME 3: A narrowing of the gap between the budget as planned and as executed												
Budget executed/budget planned	%	3.41	2018	5.0	5.0	5.0	5.0	5.0	5.0	2024	Bahia balance sheet and SEFAZ/BA Annual Budget Law	See monitoring and evaluation plan

[2] The expected outcomes are not cumulative.

OUTPUTS[3,4]

Outputs	Unit of measure	Baseline	Baseline year	Year 1	Year 2	Year 3	Year 4	Year 5	Final target	Means of verification	Comments
Component 1: Financial management and fiscal transparency											
1.1 Public governance and managing for results model[5] implemented	Model	0	2019	0	0	0	1	0	1	SEFAZ/BA management report	See monitoring and evaluation plan
1.2 Professional development model implemented	Model	0	2019	0	0	0	0	1	1		
1.3 IT management model implemented	Model	0	2019	0	0	0	0	1	1		
1.4 Public procurement model implemented	Model	0	2019	0	0	0	0	1	1		
1.5 Internal control and transparency model implemented	Model	0	2019	0	0	0	1	0	1		
Component 2: Tax administration and litigation											
2.1 Tax policy management model implemented	Model	0	2019	0	0	0	1	0	1	SEFAZ/BA management report	See monitoring and evaluation plan
2.2 Simplified tax obligation compliance model implemented	Model	0	2019	0	0	0	1	0	1		
2.3 Information management model implemented	Model	0	2019	0	0	0	0	1	1		
2.4 Oversight model implemented	Model	0	2019	0	0	0	1	0	1		

[3] Outputs are annual.

[4] Systems, models, or software will be considered completed only once used by public officials.

[5] A model is a set of activities that can include: (i) a diagnostic assessment of the current situation; (ii) a methodology and change proposal; (iii) process re-engineering; (iv) an IT solution; and (v) training on new processes and tools.

Outputs	Unit of measure	Baseline	Baseline year	Year 1	Year 2	Year 3	Year 4	Year 5	Final target	Means of verification	Comments
2.5 Model for the adjudication of tax litigation cases implemented	Model	0	2019	0	0	0	0	1	1		
2.6 Taxpayer services model implemented	Model	0	2019	0	0	0	0	1	1		
2.7 Tax management system implemented	Model	0	2019	0	0	0	1	0	1		
Component 3: Financial management and public expenditure											
3.1 Financial execution model implemented	Model	0	2019	0	0	0	0	1	1	SEFAZ/BA management report	See monitoring and evaluation plan
3.2 Small claim and court-ordered payment management system implemented	System	0	2019	0	0	0	1	0	1		
3.3 Concession contract management system implemented	System	0	2019	0	0	0	1	0	1		
3.4 Accounting management model implemented	Model	0	2019	0	0	0	0	1	1		
3.5 Public debt management model implemented	Model	0	2019	0	0	0	1	0	1		
3.6 Public cost optimization model implemented	Model	0	2019	0	0	0	0	1	1		

FIDUCIARY AGREEMENTS AND REQUIREMENTS

Country	Brazil
Project number:	BR-L1533
Name:	Fiscal Management Modernization Project for the State of Bahia – PROFISCO II-BA
Executing agency:	State of Bahia, through the Finance Department (SEFAZ/BA)
Prepared by:	David Salazar and Fábia Bueno (VPC/FMP)

I. EXECUTIVE SUMMARY

1.1 The institutional assessment for the project's fiduciary management was based on: (i) the country's current fiduciary context; (ii) the findings of the assessment of principal fiduciary risks; (iii) the MD-GEFIS report; (iv) an institutional analysis; (v) prior experience under PROFISCO I; and (vi) working meetings with the project team and SEFAZ/BA.

1.2 Brazil has robust country fiduciary systems that enable sound management of administrative, financial, oversight, and procurement processes, in accordance with the principles of transparency, economy, and efficiency. In terms of their capacity for planning and organization, execution, and oversight, the executing agency's systems have a medium level of development and pose a medium risk.

1.3 SEFAZ/BA has the legal capacity and experience to execute the project activities, as it has implemented projects jointly with the Bank in recent years (PROFISCO I) using its own structure, with a program coordination unit (PCU). The implemented and consolidated structure will be used, drawing on the lessons learned from the execution of the first phase.

II. FIDUCIARY CONTEXT OF THE EXECUTING AGENCY

2.1 The SEFAZ/BA structure consists of the Office Chief, Directorate General, Superintendency of Financial Administration, Superintendency of Tax Revenue Collection, Superintendency of Fiscal Management and Development, and Superintendency of Technical and Financial Coordination for Development.

2.2 The project will benefit SEFAZ/BA as the executing agency and the State Administration Department (SAEB).

2.3 The project activities will be executed by SEFAZ/BA, through the PCU, which will be responsible for institutional and technical coordination, linked to Modernization Coordination.

2.4 The executing agency uses the available electronic procurement systems for auction and price list modalities, as in PROFISCO I.

2.5 The executing agency is subject to both internal and external control. Internal control is conducted by the State Auditor General, whereas external control is conducted by the State Audit Office (TCE/BA), the entity that audits all state entities and that is eligible for performing external audits of Bank-financed operations.

III. INSTITUTIONAL CAPACITY ASSESSMENT, FIDUCIARY RISK EVALUATION, AND MITIGATION ACTIONS

3.1 The assessment and validation of institutional capacity with SEFAZ/BA staff concluded that the executing agency has sufficient and adequate institutional capacity with targeted opportunities for improvement in the execution of operations with the Bank.

3.2 A medium-high fiduciary risk was identified related to potential delays in procurement processes, affecting program execution times. This risk will be mitigated through the coordinated approval of the procurement plan by SEFAZ/BA and SAEB and through the adoption of a procurement processing flow.

IV. AGREEMENTS AND REQUIREMENTS FOR PROCUREMENT EXECUTION

A. Procurement execution

4.1 **Procurement of works, goods, and nonconsulting services.** Contracts will be subject to international competitive bidding (ICB) and will be performed using the standard bidding documents issued by the Bank. Bidding processes subject to national competitive bidding (NCB) will be executed using national bidding documents agreed upon with the Bank.

4.2 **Selection and contracting of consultants.** Contracts will be executed using the standard request for proposals issued by the Bank. Selection and contracting will comply with the Policies for the Selection and Contracting of Consultants financed by the Inter-American Development Bank (document GN-2350-9).

4.3 **Use of the country procurement system.** The country procurement subsystem approved by the Bank, *Pregão Eletrônico*, will be used to procure off-the-shelf goods, up to US$5 million. Any subsequently approved system or subsystem will apply to the operation. The procurement plan and its updates will indicate which procurement will be executed through the approved country systems.

B. Single-source selection

4.4 **Government entities and schools.** Given the way in which finance departments in Brazil are structured, there are entities in charge of knowledge and skills development: (i) the National School of Public Administration of the Ministry of Economy; (ii) government schools that provide training to public officials; (iii) data processing companies, responsible for states' IT development; and (iv) federal and state universities that provide technical assistance in new IT solutions. Considering paragraphs 1.11(c) and 3.10 of document GN-2350-9 and to ensure the sustainability of the outputs developed and financed by the project, single-source selection of federal and state entities dedicated to training for officials and IT development is planned. In this project specifically, single-source selection is planned in order to select state-owned company PRODEB, which implemented the state's Integrated Planning, Accounting, and Finance System (FIPLAN) and will execute the new FIPLAN functionalities provided for in the project, with an estimated value of US$4 million.

4.5 **Technical research and IT advisory services.** Pursuant to paragraph 3.10 of document GN-2350-9, single-source selection of *Gartner do Brasil Serviços de Pesquisas Ltda* is planned, as this firm has exceptional experience and qualifications to provide the required consulting services. The estimated value of this contract is US$350,000.

Table 1. Thresholds for international competitive bidding and international shortlist

Method	ICB for works	ICB for goods and nonconsulting services	International shortlist for consulting services
Threshold	US$25 million	US$5 million	US$1 million

Table 2. Main procurement items

Purpose of procurement	Selection method	Estimated date	Threshold amount (US$ million)
Goods and nonconsulting services			
Equipment for contingency environment implementation and disaster recovery	*Pregão Eletrônico*	2021-Q2	2.3
Software factory	*Pregão Eletrônico*	2020-Q4	4.9
Consulting services firms			
Gartner	Single-source	2020-Q2	0.4
Process change management system	QCBS	2020-Q4	1.3
Development of new FIPLAN functionalities	Single-source	2020-Q2	4.0

C. Procurement supervision

4.6 Procurement will be subject to ex post supervision, except where ex ante supervision is justified. When the country system is used for procurement, the country system will also be used for supervision.

4.7 The supervision method will be determined for each selection process. Ex post reviews will be conducted every twelve months in accordance with the project supervision plan.

Table 3. Ex post review threshold

Works	Goods	Consulting services
NCB and shopping	NCB	Less than US$1 million

D. Records and files

4.8 The PCU will be responsible for process documentation and will retain the necessary documentation for supervision and auditing purposes.

V. Financial Management

5.1 **Programming and budget.** SEFAZ/BA will be responsible for planning PROFISCO II activities, and the PCU will be responsible for the execution and control of activities as set out in the multiyear execution plan and annual work plan. State entities use the multiyear planning instruments, Budget Procedures Law, which lays out the budget guidelines, and the Annual Budget Law (LOA). The program budget will be part of the LOA.

5.2 The PCU will ensure that project resources, both the Bank financing and the local contribution, are budgeted annually and secured for execution according to the project schedule. Budgetary funds will be recorded as an external source within the FIPLAN in the year of execution. The LOA will include the funds needed for execution, both for the external loan and for the local contribution.

5.3 **Accounting and information systems.** Public entities in Bahia use FIPLAN, which comprises financial, budget, and accounting management. The system is auditable and has access profiles and security guidelines. It also complies with Bank requirements on controls and will be used to execute PROFISCO II. To supplement this, PROFISCO II disbursement and external audit reports for the Bank will be generated by the management report system based on FIPLAN data.

5.4 **Disbursements and cash flow.** The project will use the SEFAZ/BA treasury system. Expenditures will be subject to financial and budget implementation processes and will be duly recorded in FIPLAN.

5.5 As in PROFISCO I, the Bank funds will be managed through an exclusive account that enables the loan proceeds to be identified and the respective bank reconciliations to be performed, including income and payments.

5.6 Disbursements will be made in United States dollars as advances of funds and will be based on a projection of financial needs for a maximum of 180 days. SAF/SEFAZ Regulation 18 establishes the release of the financial programming quotas of its administration units only where financial resources are available, meaning that new hires are only possible when the corresponding financial balance is available. In that regard, based on paragraph 3.3(i) of the Financial Management Guidelines for IDB-financed Projects (document OP-273-12), at least 50% of the advanced amount will be required for accountability reporting purposes.

5.7 Expenses considered ineligible by the Bank will be reimbursed from the local contribution or from other funds at the Bank’s discretion, depending on the nature of the ineligibility.

5.8 The exchange rate agreed with the executing agency to account for expenses paid for with loan proceeds from the advances of funds will be the internalization rate. To determine the equivalency of incurred expenditures charged to the local contribution or reimbursed from the loan proceeds, the agreed exchange rate will be the buy rate established by the Central Bank of Brazil effective on the date of payment of the eligible project expenses.

5.9 **Internal control and internal audit.** Bahia's State Auditor General is responsible for state internal control. Its activities are performed through coordination of the internal control of government departments and decentralized agencies of the state's executive branch. Project activities will be under its control.

5.10 **External control and reports.** External control will be conducted by the TCE/BA.

5.11 Annual audited financial statements will be submitted in accordance with the terms of reference agreed with the Bank within 120 days following the close of each fiscal year.

5.12 **Financial supervision plan.** This plan may be amended during execution in response to evolving risk levels or due to additional control needs.

Table 4. Supervision plan

Nature/Scope	Frequency	Responsible party	
		Bank	Executing agency
Ex post review of disbursements and procurement	Annual	Fiduciary team	PCU - TCE/BA
Annual audit	Annual	Fiduciary team	PCU - TCE/BA
Review of disbursement requests	Periodic	Fiduciary team	
Supervision visits	Annual	Fiduciary specialist	

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION DE-__/19

Brazil. Loan ____/OC-BR to the State of Bahia. Fiscal Management Modernization Project for the State of Bahia – PROFISCO II – BA. Twelfth Individual Loan Operation under the Conditional Credit Line for Investment Projects (CCLIP) BR-X1039 – Fiscal Management Modernization Program in Brazil – PROFISCO II

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with the State of Bahia, as Borrower, and with the Federative Republic of Brazil, as Guarantor, for the purpose of granting the former a financing aimed at cooperating in the execution of the Fiscal Management Modernization Project for the State of Bahia – PROFISCO II – BA, which constitutes the twelfth individual loan operation under the Conditional Credit Line for Investment Projects (CCLIP) BR-X1039 – Fiscal Management Modernization Program in Brazil – PROFISCO II, approved on 8 December 2017 by Resolution DE-113/17. Such financing will be for the amount of up to US$40,000,000, from the resources of the Bank's Ordinary Capital, and will be subject to the Financial Terms and Conditions and the Special Contractual Conditions of the Project Summary of the Loan Proposal.

(Adopted on _______________ 2019)

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